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What Our Students have to say....

Pooja
Whenever I listen to Suraj sir's lecture, feels like I've completed the concept! Made it veryyyy simple sir! Pranams!

Sugam
1Fin is working very hard and providing aeverything we need for CA.
Thanks for the support

Parthi purush
Really I'm impressed on his teaching style and it's like a movie and interesti

Kumar G
Much needed classes for CA! Thank you ! IL team

Nilesh
Excellent explanation and you made easy to understand for anyone. Superb.. I was always confused.. now everything is clear. Amazing Sir!

Jagadeesh Chandra
One of best explanation about the concepts among any other avialable...Thanks Sir, thank you 1fin

Purva Kirad
Very nice explanation of all concpets! thank you

KAVITHA
Very clear explanation sir .
I was not able to understand before but now u have given a clarity. Thank you so much sir...

Jayashree
Really the classes were very useful for my preparation....
Thanks a lot InidgoLearn

akhila
Crystal clear Thank you sir for such an amazing classes

Daniel Philip
Very nice lectures and great explanation sir thank you lots!

Our Rankers

AIR 49

412/600

Hamsa Gayatri
CA Final Sep-25

AIR 27

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Sudeepta Benya
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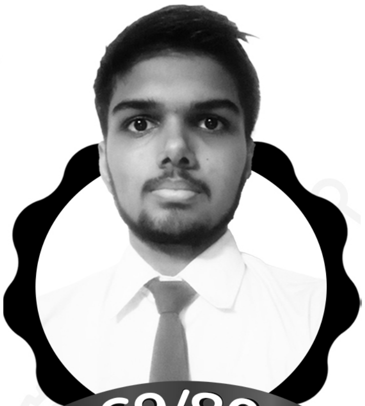
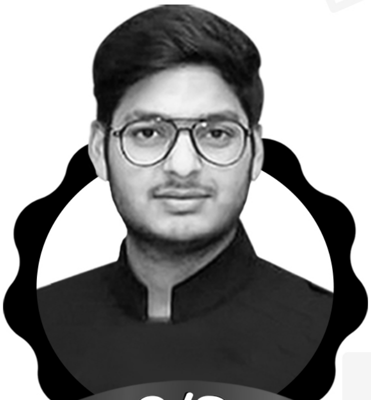
AIR 5



669/800

Sarthak
CA Inter May-23

AIR 19



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Aman Mahajan
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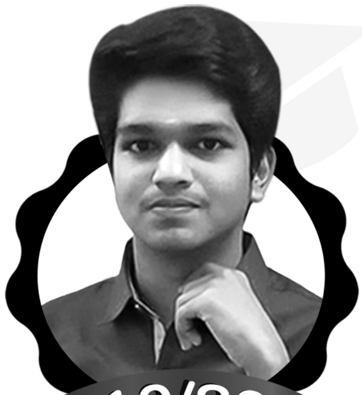
AIR 33



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Sundar B
CA Inter Dec-21

AIR 49

542/800

Ria Gupta
CA Inter May-22

Disclaimer

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Note – The chapters have been arranged in a different order from the study material to ensure logical

CONTENTS

INTRODUCTION TO ACCOUNTING STANDARDS

1. GAAP

Generally accepted accounting principles (GAAP) refer to a common set of accepted accounting principles, standards, and procedures that business reporting entity must follow when it prepares and presents its financial statements.

Accounting Standards (ASs) are written policy documents w.r.t accounting transaction or events in the financial statements of entities which deal with

- Recognition of events and transactions
- measurement;
- presentation; and
- disclosure.

of assets, liabilities, revenue, expense and other items of financial statements

They ensure

- Standardisation of alternative accounting treatments
- Comparability of financial statements of various organisations

Accounting Standards reduce the accounting alternatives in the preparation of financial statements within the bounds of rationality, thereby, ensuring comparability of financial statements of different enterprises.

2. Accounting Standards in India

There are 27 Accounting Standards at present. The 'Accounting Standards' issued by the Accounting Standards Board establish standards which have to be complied by the business entities so that the financial statements are prepared in accordance with GAAP.

AS No.	***AS Title***	***Date of applicability***
1	Disclosure of Accounting Policies	01/04/1993
2	Valuation of Inventories (Revised)	01/04/1999
3	Cash Flow Statement	01/04/2001
4	Contingencies and Events Occurring after the Balance Sheet Date (Revised)	01/04/1998
5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	01/04/1996
7	Construction Contracts	01/04/2002
9	Revenue Recognition	01/04/1993
10	Property, Plant and Equipment (Revised)	01/04/2016
11	The Effects of Changes in Foreign Exchange Rates (Revised)	01/04/2004
12	Accounting for Government Grants	01/04/1994
13	Accounting for Investments (Revised)	01/04/1995
14	Accounting for Amalgamations (Revised)	01/04/1995
15	Employee Benefits	01/04/2006
16	Borrowing Costs	01/04/2000
17	Segment Reporting	01/04/2001
18	Related Party Disclosures	01/04/2001
19	Leases	01/04/2001
20	Earnings Per Share	01/04/2001
21	Consolidated Financial Statements (Revised)	01/04/2001
22	Accounting for Taxes on Income	01/04/2006
23	Accounting for Investments in Associates in Consolidated Financial Statements	01/04/2002
24	Discontinuing Operations	01/04/2004
25	Interim Financial Reporting	01/04/2002
26	Intangible Assets	01/04/2003

27	Financial Reporting of Interests in Joint Ventures	01/04/2002
28	Impairment of Assets	01/04/2008
29	Provisions, Contingent Liabilities and Contingent Assets (Revised)	01/04/2004

3. IFRS vs Ind AS vs AS

Generally accepted accounting principles (GAAP) are a set of accepted accounting principles, standards, and procedures that entity must follow when it prepares and presents its financial statements. GAAP is a combination of authoritative standards (set by policy boards) and the commonly accepted ways of recording and reporting accounting information.

At international level, such authoritative standards are known as International Financial Reporting Standards (IFRS) at many places and in India we have authoritative standards named as Accounting Standards (ASs) and Indian Accounting Standard (Ind AS).

International Financial Reporting Standards (IFRS) are considered as a "principles-based" set of standards used internationally. IFRS comprises IFRS issued by IASB; IAS issued by IASC; Interpretations issued by the Standard Interpretations Committee (SIC) and the IFRS Interpretations Committee of the IASB.

Ind AS are IFRS converged standards issued by the Central Government of India under the supervision and control of ASB of ICAI and in consultation with NFRA. NFRA recommends these standards to the MCA. MCA has to spell out the accounting standards applicable for companies in India. Ind AS are named and numbered in the same way as the corresponding IAS

As per the MCA Notification dated 16th February 2015, Ind AS converged with IFRS shall be implemented on voluntary basis from 1st April, 2015 and mandatorily from 1st April, 2016.

4. Benefits of Accounting Standards

a. Standardisation of alternative accounting treatments

There can be various ways to treat items in financial statements. Accounting Standards aim to standardize accounting practices and presentation of financial information in order to reduce confusion in the treatment of economic events during the preparation of financial statements.

These standards provide guidelines for various accounting areas such as inventory valuation, cost capitalization, depreciation, and amortization. Entity must also disclose accounting policy followed in preparation of financial statements. For instance, they should reveal the chosen cost formula for inventory valuation, such as FIFO or Weighted Average.

b. Requirements for additional disclosures

There are certain areas where information is not statutorily required to be disclosed. However, accounting standards may call for appropriate disclosures of accounting policies followed and other required information in the financial statements which would be helpful for readers to understand the accounting treatment done for various items in those financial statements. In case of conflict between statute and accounting standards, the provisions of statute would be followed.

c. Comparability of financial statements

Since Accounting standards help in standardization of accounting process, inter firm comparision (comparison between different entities) and intra firm comparison (year on year comparison) becomes effective. This helps users to take informed decision.

d. Reduction in scope of creative accounting

Creative accounting refers to manipulating accounting policies to produce financial statements which would not reflect the true performance and financial position.

Recognising future revenue in current year, capitalisation of revenue expenditure etc can result in increased profits. Accounting standards provide guidance and principles to avoid such creative accounting.

5. Standard Setting Process

The ICAI has taken significant initiatives for the issuance of AS to ensure the standard setting process is fully consultative and transparent.

ICAI constituted Accounting Standards board (ASB) in 1977 which considers the International Accounting Standards (IASs) / International Financial Reporting Standards (IFRS) while framing AS.

The composition of ASB Includes representatives of Industries, associations of Industries, regulators, academicians, government departments etc.

NFRA (National financial reporting authority) recommends standards to the MCA and MCA notifies the accounting standards applicable for companies In India.

The standard setting process of ASB is outlined below –

Identification of Area	Broad areas for formulation of AS
Constitution of study groups	• Consider specific projects • Prepare preliminary drafts of proposed AS • Consideration of preliminary draft and revision if required
Preparation of draft & Circulation	• Circulation of draft AS to council members of the ICAI, MCA, SEBI, CAG, CBDT, SCOPE (Standing conference of public enterprises)
Ascertainment of views of diff bodies	• Meet representatives of bodies to ascertain views on the draft of the proposed AS
Finalisation of Exposure draft	• Finalising of draft and inviting public comments
Comments received on Exposure Draft	• Consideration of comments received on the exposure draft and finalization the draft for submission to council of ICAI
Modification of draft	• Consideration of the final draft of the proposed standard & modification if required
Issue of AS	• For Non Corporate entities – issued by ICAI • For corporate entities – Issued by MCA in consultation with NFRA.

6. Need for Convergence towards Global Standards

Convergence of accounting standards is the goal of establishing a single set of accounting standards that will be used internationally.

Aspects which required the need for convergence are

A. Raising funds from international markets:
Each country has its own set of rules and regulations for accounting and financial reporting. The rules and regulations of the other country will apply to an enterprise in case It decides to raise capitals from the markets of other countries.

B. Comparability of financial statements
International analysts and Investors would like to compare financial statements based on similar ASs, and this has led to the growing need for an Internationally accepted set of ASs for cross-border filings. The harmonization of financial reporting around the world will help to raise confidence of Investors, generally, In the Information they are using to make their decisions and asses their risks.

C. Uniformity, comparability transparency etc.:
A strong need was felt by legislation to bring about uniformity, rationalism, comparability, transparency and adaptability In FS. If the accounting for the same events and Information produces different reported numbers, It will create a confusion, encourages error and may facilitate fraud. the cure Is to have a single set of global standards of the highest quality set In the Interest of public.

D. Global Investment:
The convergence of FR and ASs Is a valuable process that contributes to the free flow of global Investments and achieves substantial benefits for all capital market stakeholders.

7. International Accounting Standards (IASB)

The International Accounting Standards Committee (IASC) Is responsible for developing International Accounting Standards (IAS), was established In June,1973. It Is presently known as IASB. The IASC comprises the professional accountancy bodies of over 75 countries.

8. International Financial Reporting Standards (IFRS) as Global standards

IFRS	IFRS issued by IASB
	Interpretations on IAS/IFRS issued by IFRS interpretation committee
	Interpretation on IAS issued by SIC
	IAS issued by IASC and adopted by IASB

9. Becoming IFRS Compliant

Technique I - Adoption process
It means that the country sets a specific timeline when specific entities would be required to use IFRS as Issued by the IASB. This is typically followed in some European Countries.

Technique II - Convergence process
It means that the country will develop high quality, compatible AS and there would be alignment of the standards of different standard setters with a certain rate of compromise, by adopting the requirements of the standards either fully or partially.

Ind AS are almost similar to IFRS but with few carve ins/outs so as to make them suitable for Indian environment. A carve-out is a difference from the practices and principles of international standards. A carve-in is additional guidance given in Ind AS that is not given in IFRS.

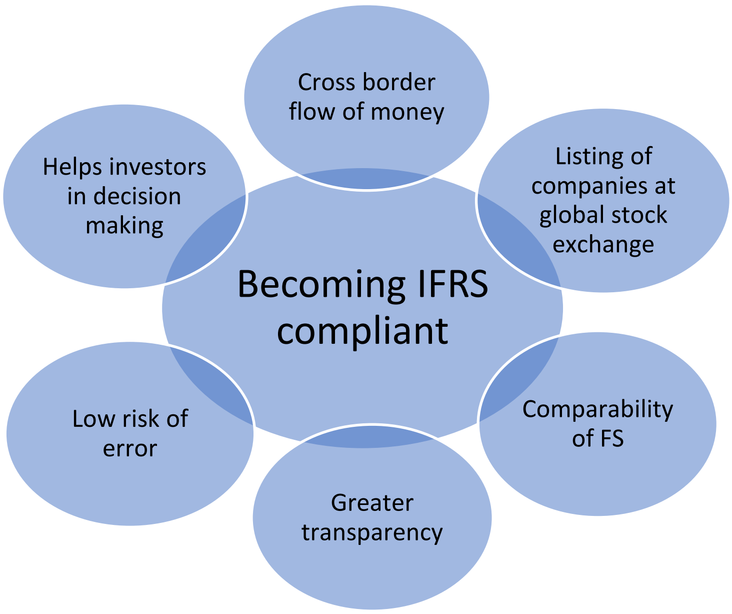
Reasons for Differences between IFRS and Ind AS

- Terminology Difference – Use of Statement of Profit & Loss instead of Statement of Comprehensive Income and Balance Sheet instead of Stagement of Financial Position.

- Removal of options in accounting principles and practices – Some options given in IAS/IFRS have been removed in Ind AS. This does not result in carve out.
- Difference in economic environment – The economic environment in India is different from those in western countries. These require different accounting treatments and result in deviation to the accounting principles and practices in IFRS. These are generally called carve outs.

Removal of options is not carve out whereas deviation in accounting principles results in carve outs.

Benefits of convergence with IFRS:
A. Improves Investor confidence across the world with transparency and comparability.
B. Improves Inter-unit/ Inter-firm/ Inter-Industry comparison.
C. Group consolidation will be easy with same standard by all companies In group Irrespective of their global location.
D. Acceptability of FS by stock exchanges across the globe, which facilitate listing of Indian companies to international stock exchanges.



10. Indian Accounting Standards (IND AS)

Ind AS are IFRS converged standards issued by the Central government of India under the supervision and control of ASB of ICAI in consultation with NFRA. NFRA recommends the standards to the MCA.

Ind AS are named and numbered in the same way as the corresponding IAS/IFRS.
IAS 1 -> Ind AS 1
IFRS 1 -> Ind AS 101
(Add 100 to IFRS numbers)

Indian Accounting Standards

- Globalization and Liberalization
- Transparency of FS
- Comparability of FS
- Enhanced Disclosure requirements

List of notified IND AS:

Ind AS	IAS/IFRS	Title of Ind AS/ IFRS	AS/GN	AS/GN Title
101	IFRS 1	First Time Adoption of Indian Accounting Standards	-	-
102	IFRS 2	Share Based Payment	GN	Guidance Note on Accounting for Share-based Payments
103	IFRS 3	Business Combinations	AS 14	Accounting for Amalgamations
105	IFRS 5	Non-current Assets Held for Sale and Discontinued Operations	AS 24	Discontinuing Operations
106	IFRS 6	Exploration for and Evaluation of Mineral Resources	GN 15	Guidance Note on Accounting for Oil and Gas Producing Activities
107	IFRS 7	Financial Instruments: Disclosures	-	-
108	IFRS 8	Operating Segments	AS 17	Segment Reporting
109	IFRS 9	Financial Instruments	-	-
110	IFRS 10	Consolidated Financial Statements	AS 21	Consolidated Financial Statements
111	IFRS 11	Joint Arrangements	AS 27	Financial Reporting of Interests in Joint Ventures
112	IFRS 12	Disclosure of Interests in Other Entities	-	-
113	IFRS 13	Fair Value Measurement	-	-
114	IFRS 14	Regulatory Deferral Accounts	GN	Accounting for Rate Regulated Activities
115	IFRS 15	Revenue from Contracts with customers	AS 7 AS 9	Construction Contract Revenue Recognition
116	IFRS 16	Leases	AS 19	Leases
	IFRS 17	Insurance Contracts		
1	IAS 1	Presentation of Financial Statements	AS 1	Disclosure of Accounting Policies
2	IAS 2	Inventories	AS 2	Valuation of Inventories
7	IAS 7	Statement of Cash Flows	AS 3	Cash Flow Statements
8	IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors	AS 5	Net Profit or Loss for the Period, Prior period Items

				and Changes in Accounting Policies
10	IAS 10	Events after the Reporting Period	AS 4	Contingencies and Events Occurring After the Balance Sheet date
12	IAS 12	Income Taxes	AS 22	Accounting for Taxes on Income
16	IAS 16	Property, Plant and Equipment	AS 10	Property, Plant and Equipment
19	IAS 19	Employee Benefits	AS 15	Employee Benefits
20	IAS 20	Accounting for Government Grants and Disclosure of Government Assistance	AS 12	Accounting for Government Grants
21	IAS 21	The Effects of Changes in Foreign Exchange Rates	AS 11	The Effects of Changes in Foreign Exchange Rates
23	IAS 23	Borrowing Costs	AS 16	Borrowing Costs
24	IAS 24	Related Party Disclosures	AS 18	Related Party Disclosures
27	IAS 27	Separate Financial Statements	-	-
28	IAS 28	Investment in Associates and Joint Ventures	AS 23	Accounting for Investment in Associates in Consolidated Financial Statements
29	IAS 29	Financial Reporting in Hyperinflationary Economies	-	-
32	IAS 32	Financial Instruments: Presentation	-	-
33	IAS 33	Earnings per Share	AS 20	Earnings per Share
34	IAS 34	Interim Financial Reporting	AS 25	Interim Financial Reporting
36	IAS 36	Impairment of Assets	AS 28	Impairment of Assets
37	IAS 37	Provisions, Contingent Liabilities and Contingent Assets	AS 29	Provisions, Contingent Liabilities and Contingent Assets
38	IAS 38	Intangible Assets	AS 26	Intangible Assets
40	IAS 40	Investment Property	AS 13	Accounting for Investments
41	IAS 41	Agriculture	-	-

1. Roadmap for Implementation of IND AS

For companies other than Banks, NBFCs and Insurance Companies

Phase I:
1st April 2015 or thereafter: Voluntary basis for any company and Its holding, subsidiary, joint venture or associate company.

1st April 2016: Mandatory Basis
a. Companies listed/In process of listing on Stock Exchanges In India or outside India having net worth of INR 500cr or more;
b. Unlisted companies having net worth of INR 500cr or more;
c. Parent, subsidiary, associate and JV of above.

Phase II:

(a) All companies which are listed/or in process of listing on Stock Exchanges in India or outside India not covered in Phase I (other than companies listed on SME Exchanges);

(b) Unlisted companies having net worth of INR 250 crore or more but less than INR 500 crore;

(c) Parent, Subsidiary, Associate and JV of above.

Special Points

1. Companies listed on SME exchange are not required to apply Ind AS.
2. Once Ind AS are applicable, an entity shall be required to follow the Ind AS for all the subsequent FS
3. Companies not covered above shall continue to apply AS notified in Companies Rules,2006

For Non-Banking Financial Companies (NBFCs), Scheduled Commercial Banks (Excluding RRBs) and Insurers/Insurance Companies and

Non-Banking Financial Companies (NBFCs)	
Phase I:	From 1st April, 2018 (with comparatives)
	• NBFCs (whether listed or unlisted) having net worth INR 500 crores or more
	• Holding, Subsidiary, JV and Associate companies of above NBFC other than those already covered under corporate roadmap shall also apply from said date.
Phase II:	From 1st April, 2019 (with comparatives)
	• NBFCs whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India and having net worth less than INR 500 crores
	• NBFCs that are unlisted having net worth INR 250 crores or more but less than INR 500 crores
	• Holding, Subsidiary, JV and Associate companies of above companies other than those already covered under corporate roadmap shall also apply Ind AS from the said date.
➢ Applicable to both Consolidated and Individual Financial Statements	
➢ NBFC having net worth below INR 250 crores and not covered under the above provisions shall continue to apply ASs specified in Annexure to Companies (Accounting Standards) Rules, 2006.	
➢ Adoption of Ind AS is allowed only when required as per the roadmap.	
➢ Voluntary adoption of Ind AS is not allowed.	
Scheduled Commercial banks (excluding RRBs)	

- Scheduled Commercial Banks (SCBs) excluding Regional Rural Banks (RRBs) were initially required to implement Ind AS from 1 April 2018. However, RBI (Reserve Bank of India) vide a press release dated 5 April 2018, deferred the implementation of Ind AS by one year i.e. to be effective from 1 April 2019 instead of 1 April 2018.
- Further, the RBI through a notification dated 22 March 2019, deferred the Ind AS implementation till further notice. Urban Cooperative banks (UCBs) and Regional Rural banks (RRBs) are not required to apply Ind AS.

Insurers/Insurance companies

- MCA had outlined the road map for implementation of Ind AS by insurers/insurance companies from 1 April 2018.
- IRDAI (Insurance Regulatory and Development Authority of India) deferred the implementation of Ind AS in the insurance sector in India for a period of two years whereby the effective date was deferred to 1st April 2020.

IRDAI, vide circular dated 21 January 2020, has deferred implementation of Ind AS in the insurance sector till further notice.

Framework for Preparation and Presentation of Financial Statements (FS)

1 Purpose of the framework

- Assist enterprises in preparation of the FS in compliance with Accounting Standards and dealing with topics not covered by AS.
- Assist Accounting Standards Board (ASB) in task of development and review of SA
- Assist ASB in promoting harmonisation of regulations, AS and procedure relating to the preparation of FS.
- Assist auditors in forming an opinion as to whether financial statements confirm to AS.
- Assist users in interpretation of financial statements.

2 Scope of the framework

- Applies to general purpose financial statements which are prepared for external users.
- Special purpose financial statements (e.g for bank loan, income tax) are outside the scope.

Users of FS

- Investors
- Lenders
- Govt.
- Public
- Employees
- Customers
- Suppliers

Nothing in the framework overrides any specific Accounting Standard. In case of conflict between an Accounting Standard and the framework, the requirements of the Accounting Standard will prevail over those of the framework.

3 Areas Covered

The principal areas covered by the framework are as follows:

(a) Components of financial statements;
(b) Objectives of financial statements;
(c) Assumptions underlying financial statements;
(d) Qualitative characteristics of financial statements;
(e) Elements of financial statements;
(f) Criteria for recognition of elements in financial statements;
(g) Principles for measurement of financial elements;
(h) Concepts of Capital and Capital Maintenance.

4 Components of Financial Statements

The objective of financial statements is to provide information about the financial position, performance and cash flows of an enterprise that is useful to a wide range of users in making economic decisions.

Financial Statements

- Balance Sheet
- Profit & Loss A/c
- Cash Flow Statement
- Notes & other Statements

Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise.
Financial statements should have the following characteristics to serve the purpose for which they are made:

- Understandable
- Relevant
- Reliable
- Comparable

5 Fundamental Accounting Assumptions (Refer AS-1)

Fundamental Accounting Assumptions		
	Going Concern	Financial statements are normally prepared on the assumption that an enterprise will continue in operation in the foreseeable future
	Accrual	revenues and costs are accrued, that is, recognised as they are earned or incurred
	Consistency	accounting policies are consistent from one period to another. The consistency improves comparability

An accounting policy can be changed if the change is required
(i) by a statute or
(ii) by an Accounting Standard or
(iii) for more appropriate presentation of financial statements.

6 Elements of Financial Statements

Asset	resource controlled by the enterprise as a result of past events from which future economic benefits are expected
Liability	present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow of a resource embodying economic benefits.
Equity	residual interest in the assets of an enterprise after deducting all its liabilities.
Income	increase in economic benefits during the accounting period in the form of inflows or enhancement of assets or decreases in liabilities that result in increase in equity
Expenses	decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decrease in equity

Equity = Assets – Liabilities

7 Measurement of Elements

Measurement is the process of determining money value at which an element can be recognised in the balance sheet or statement of profit and loss. The framework recognises four alternative measurement bases.

- **Historical Cost** i.e acquisition price
- **Current Costs** i.e cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently
- **Realisable Costs** i.e. cash or cash equivalents currently realisable on sale of the asset in an orderly disposal

- **Present Value** i.e an amount, one has to invest on current date to have an amount (A) after n years. If the rate of interest is R then

$$A = P(1+R)^n$$

The process of obtaining present value of future cash flow is called discounting. The rate of interest used for discounting is called the discounting rate. The expression $[\frac{1}{(1+R)^n}]$, called discounting factor which depends on values of R and n.

8 Qualitative Characteristics of Financial Statements

Understandability	The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities and accounting
Relevance	The financial statements should contain relevant information only. Information, which is likely to influence the economic decisions by the users, is said to be relevant. Such information may help the users to evaluate past, present or future events or may help in confirming or correcting past evaluations The relevance of a piece of information should be judged by its materiality. A piece of information is said to be material if its misstatement (i.e., omission or erroneous statement) can influence economic decisions of a user taken on the basis of the financial information.
Reliability	The information must be reliable – free from material error and bias. ▪ Transactions and events reported are faithfully represented. ▪ Transactions and events are reported on the principle of 'substance over form (discussed later in AS-1)'. ▪ The reporting of transactions and events are neutral, i.e. free from bias. ▪ Prudence is exercised in reporting uncertain outcome of transactions or events. ▪ The information in financial statements must be complete.
Comparability	The financial statements should permit both inter-firm and intra-firm comparison. One essential requirement of comparability is disclosure of financial effect of change in accounting policies

Constraints on relevant and reliable information

Timeliness	**Balance between benefit and cost**
If there is delay in reporting of information, then it loses relevance.	The benefits derived from information should exceed the cost of providing it.
If reporting is done without obtaining all information, it may not be reliable	If huge amount of cost is incurred to get reliable and relevant information, it does not serve purpose.

9 True and fair view

Financial statements are required to show a true and fair view of the performance, financial position and cash flows of the enterprise.

10 Capital Maintenance

Capital refers to net assets of a business.

Opening Capital (Opening Assets – Opening Liability)	**Xxxx**
(+)Add: Profits made during the period (-)Less: Losses made during the period	Xxxx
(+)Add: Capital Introduced	Xxxx
(-)Less: Drawings	Xxxx
Closing Capital (Closing Assets – Closing Liabilities)	**xxxx**

$$(OA - OL) + P + C - D = (CA - CL)$$
$$P = (CA - CL) - (OA - OL) - C + D$$

Where: Profit = P

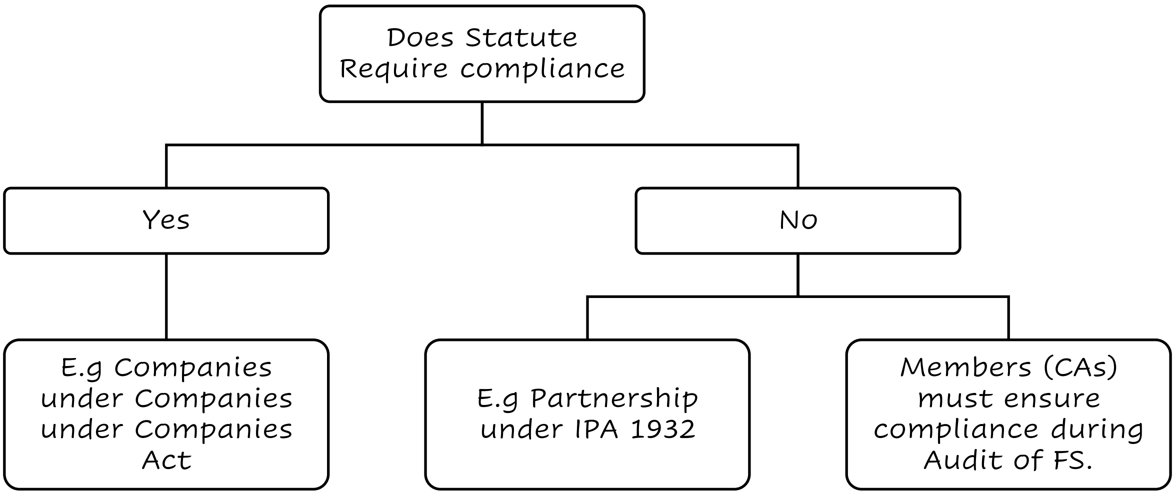
- Opening Assets = OA and Opening Liabilities = OL
- Closing Assets = CA and Closing Liabilities = CL
- Introduction of capital = C and Drawings / Dividends = D
- Retained Profit = P − D = (CA − CL) − (OA − OL) − C

A business should ensure that Retained Profit (RP) is not negative, i.e. closing equity should not be less than capital to be maintained, which is sum of opening equity and capital introduced.

APPLICABILITY OF ACCOUNTING STANDARDS

Accounting standards apply to any enterprise engaged in commercial, industrial or business activities, whether or not profit oriented and even if established for charitable or religious purposes. Accounting standards would not apply to enterprises who do not carry out any commercial, industrial or business activities.

1. Requirement of statute



If a statute (say companies act) requires compliance with Accounting standard, the enterprise must comply with the AS.

If statute governing the enterprise does not require compliance with the accounting standards, the members of the Institute are required to ensure compliance while attesting (auditing) the financial statements.

2. Mandatory Requirement under Companies Act

S.129(1)	Companies should present financial statements in compliance with AS notified u/s 133
S.143(3)(e)	Auditor to report on compliance with accounting standards.
S.129(5)	If AS are not complied, the fact and financial effect should be disclosed.

In case of following companies, respective Acts prescribe disclosure requirements. Accounting treatment prescribed by the acts and rules are applied for preparation and presentation of financial statements. Accounting Standards are applicable only to the extent they are not inconsistent with the requirements of the acts.

Banking Companies	Banking Regulation Act, 1949
Insurance Companies	Insurance Act, 1938; IRDAI Act, 1999
Electricity Companies	Electricity Act, 2003

As per companies Act,
"**Nothing contained in Section 129(1)** shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity, or to any other class of company **for which a form of financial statement has been specified in or under the Act governing such class of company.**"

3. Financial Items to which Accounting standards Apply

The accounting standards are intended to apply only to items, which are material. Materiality s considered when its omission or misstatement is likely to affect economic decision of the user.

Accounting standards intend to reduce diversity in application of accounting principles. They improve comparability of financial statements and promote transparency and fairness in their presentation.

4. Accounting Standards and Income Tax 1961

An enterprise may choose an accounting policy to prepare financial statements. Expenses and incomes are recognised based on the accounting policy chosen by the government. On the other hand, Deductions and exemptions allowed in computation of taxable income, is a matter of fiscal policy of the government.

Enterprises might try to avoid taxation or reduce taxable income by choosing accounting policy which suits them. Hence Income Tax Act 1961 prescribes certain standards to ensure consistency in reporting income.

Income Computation and Disclosure Standards

ICDS 1 : Accounting Policies
ICDS II : Valuation of Inventories
ICDS III : Construction Contracts
ICDS IV : Revenue Recognition
ICDS V : Tangible Fixed Assets
ICDS VI : The Effects of Changes in Foreign Exchange Rates
ICDS VII : Government Grants
ICDS VIII : Securities
ICDS IX : Borrowing Costs
ICDS X : Provisions, Contingent Liabilities and Contingent Assets

5. Classification of Non Corporate entities and applicability of accounting standards (prescribed by ICAI)

Compliance with Accounting Standards requires cost and resources and hence it may not be practicable for all entities to comply with Accounting Standards. ICAI has classified enterprises in two categories for determining applicability of Accounting Standards.

Category	Criteria
MSME (Micro, Small & Medium-sized Enterprise)	An entity which fulfills **all** the following: 1. Not listed or in the process of listing (in India or abroad) 2. Not a bank, financial institution, or insurance company 3. Turnover ≤ ₹250 crores (excluding other income) in preceding year 4. Borrowings ≤ ₹50 crores at any time in preceding year 5. Not a holding/subsidiary of a non-MSME
Large Entity (Non-MSME)	Any entity that **does not qualify** as an MSME. All accounting standards are applicable without any exemptions/relaxations

Conditions must be satisfied at the end of accounting period. The references to Level I,II & III enterprises should be considered as reference to MSME.

Additional requirements

- An MSME which avails the **exemptions or relaxations** given to it shall **disclose (by way of a note to its financial statements)**

- Where MSME **previously had qualified** for exemption / relaxation but **not eligible anymore** in current accounting, **need not revise previous year figures**. It should only **disclose that such relaxation is not more applicable** and **previous year figures have not been changed as per AS.**
- Where an entity has been covered Non-MSME and **subsequently gets covered in MSME**, the entity will qualify for **exemption/relaxation available only after two consecutive years** of MSME status.
- If an entity covered in MSME **opts not to avail few of the exemptions or relaxations**, it shall **disclose the Standard(s)** in respect of which it has availed the exemption or relaxation.
- An MSME may opt to avail **only some exemptions/relaxations of a particular standard**. Such **partial exemptions/relaxations should not mislead users**.

A.Standards Not Applicable in Full to All MSMEs

Standard	Title	Description
AS 3	Cash Flow Statements	Preparation of cash flow statements
AS 17	Segment Reporting	Disclosure of segment-wise financial data
AS 20	Earnings Per Share	Computation & disclosure of EPS
AS 24	Discontinuing Operations	Reporting of operations planned to be discontinued

B. Standards Not Applicable in Full to Certain MSMEs (Turnover ≤ ₹50 Cr & Borrowings ≤ ₹10 Cr)

<table>
<tr><th>Criteria</th><th>Standards Not Applicable</th></tr>
<tr><td>An entity which fulfills all the following:

1. Turnover ≤ ₹50 crores (excluding other income) in preceding year
2. Borrowings ≤ ₹10 crores at any time in preceding year
3. Not a holding/subsidiary of a MSME not covered above</td><td><table><tr><th>Standard</th><th>Title</th></tr><tr><td>AS 18</td><td>Related Party Disclosures</td></tr><tr><td>AS 28</td><td>Impairment of Assets</td></tr></table></td></tr>
</table>

C. Standards Partially Exempted – Only Specific Paragraphs Not Applicable

Standard	Para(s) Not Applicable to MSMEs	Summary of Content
AS 10 Property, Plant and Equipment	Para 87	Encouraged disclosures (e.g., historical cost reconciliation)
AS 11 Foreign Exchange Rates	Para 44	Encouraged disclosures (e.g., foreign currency risks)
AS 15 Employee Benefits	Paras: 11–16, 46, 50–123, 129–131, 139	Recognition & measurement of non-vesting leaves, defined benefit plans, discounting of liabilities, long-term benefits – MSMEs can use simplified methods
AS 19 Leases	Paras: 22(c)(e)(f), 25(a)(b)(e), 37(a)(f)(g), 38, 46(b)(d)(e)	Detailed disclosures on lease terms, MLPs, contingent rents, etc.
AS 22 Taxes on Income	Paras other than 4.4, 9, 20, 27–28	MSMEs need to account only for current tax. Deferred tax optional. Prior balances adjusted through reserves.

AS 26 Intangible Assets	Paras 90(d)(iii)-(iv), 98	Disclosures regarding useful life, amortisation method, etc.
AS 28 Impairment of Assets	Paras 121(g), 121(c)(ii), 121(d)(i)-(ii), 123	Can use simple estimation of "value in use" instead of present value technique. Disclosure relaxations.
AS 29 Provisions & Contingencies	Paras 66, 67	Encouraged disclosures like reconciliations of provisions

D. Special Notes

Case	Applicability
AS 14 (Amalgamations) and **AS 27** (Joint Ventures)	Generally not applicable to MSMEs ✓ But **if** such transactions exist, apply the relevant standard
AS 21, **AS 23**, **AS 27**, **AS 25**	MSMEs **need not** prepare Consolidated Financials or Interim Reports unless required or opted voluntarily

Classification of Companies under Companies Rules 2021

Since Accounting Standards are notified by MCA, Central Government have framed rules for the purpose of applicability of accounting standards in case of Companies.

Small and medium sized company (SMC)

a. Whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India.
b. Not a bank, financial institution or an insurance company.
c. Turnover does not exceed rupees two-fifty crores in the immediately preceding accounting year.
d. Does not have borrowings in excess of rupees fifty crores at any time during the immediately preceding accounting year.
e. Not a holding or subsidiary company of a company which is not a small and medium-sized company.

Category	Condition
Debt / Equity Listed	Should not be listed or in process of listing in India or outside India
Type of company	Should not be a bank, financial Inst or Insurance Co.
Turnover (PY) (Excluding Other Income)	Should not exceed (≤) 250 Crores
Borrowing (Inc. Public Deposits)	Should not exceed (≤) 50 crores
Holding/Subsidiary	Should not be a holding/Subsidiary of a non-SMC

Non-SMC

Companies which are not SMC are considered as Non-SMC

Note: An existing company which was previously not a SMC and subsequently becomes a SMC, shall not be qualified for exemption or relaxation in respect of Accounting Standards available to a SMC until the company remain a SMC for two consecutive accounting periods.

There are some exemptions or relaxations for small and medium sized companies(SMC) as defined in the notification dated June 23, 2021, issued by the Ministry of Corporate Affairs, Government of India

All accounting standards are applicable to Non-SMC. But applicability of all AS is not mandatory for SMCs.

Accounting Standard	Applicable (Yes / No) to SMC
AS 1 Disclosure of Accounting Policies	Yes
AS 2 Valuation of Inventories	Yes
AS 3 Cash Flow Statements	No
AS 4 Contingencies and Events Occurring After the Balance Sheet Date	Yes
AS 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	Yes
AS 7 Construction Contracts	Yes
AS 9 Revenue Recognition	Yes
AS 10 Property, Plant and Equipment	Yes
AS 11 The Effects of Changes in Foreign Exchange Rates	Yes
AS 12 Accounting for Government Grants	Yes
AS 13 Accounting for Investments	Yes
AS 14 Accounting for Amalgamations	Yes
AS 15 Employee Benefits	Partial
AS 16 Borrowing Costs	
AS 17 Segment Reporting	No
AS 18 Related Party Disclosures	
AS 19 Leases	Partial
AS 20 Earnings Per Share	Partial
AS 21 Consolidated Financial Statements	No
AS 22 Accounting for Taxes on Income	
AS 23 Accounting for Investments in Associates in Consolidated Financial Statements	No
AS 24 Discontinuing Operations	
AS 25 Interim Financial Reporting	Partial
AS 26 Intangible Assets	
AS 27 Financial Reporting of Interests in Joint Ventures	No
AS 28 Impairment of Assets	Partial
AS 29 Provisions, Contingent Liabilities and Contingent Assets	Partial

SMC – Guiding Principles

- Disclosure

"The Company is a Small and Medium Sized Company (SMC) as defined in the General Instructions in respect of Accounting Standards notified under the Companies Act Accordingly, the Company has complied with the Accounting Standards as applicable to a Small and Medium Sized Company."

- If SMC in previous year, but not in current year, previous year's figures are not required to be revised.

- SMC opts not to avail of the exemptions or relaxations available to an SMC in respect of any but not all the Accounting Standards, it should disclose the standard(s) in respect of which it has availed the exemption or relaxation.

- If an SMC desires to disclose the information not required to be disclosed pursuant to the exemptions or relaxations available to the SMCs, it should disclose that information in compliance with the relevant accounting standard.

- The SMC may opt for availing certain exemptions or relaxations from compliance with the requirements prescribed in an Accounting Standard:

- Provided that such a partial exemption or relaxation and disclosure should not be permitted to mislead any person or public.

- An existing company which was previously not a SMC and subsequently becomes a SMC, shall not be qualified for exemption or relaxation in respect of Accounting Standards available to a SMC until the company remains a SMC for two consecutive accounting periods.

AS – 1
Disclosure of Accounting Policies

1 Introduction

1.1 Importance

Irrespective of extent of standardisation, diversity in accounting policies is unavoidable for two reasons:

- Accounting standards cannot and do not cover all possible areas of accounting and enterprises have the freedom of adopting any reasonable accounting policy in areas not covered by a standard.
- Since enterprises operate in diverse situations, it is impossible to develop a single set of policies applicable to all enterprises for all times. The accounting standards permit more than one policy even in areas covered by it.

Differences in accounting policies lead to differences in information even if underlying transactions are the same. The qualitative characteristic of comparability of financial statements suffers due to diversity of accounting policies.

1.2 Requirements:

Enterprises must disclose

- Significant accounting policies adopted by them in the preparation & presentation of their financial statements.
- Changes in accounting policies such that the users can compare financial statements of the same enterprise for different accounting periods.

1.3 Purpose of AS – 1

- Promote better understanding of financial statements by requiring disclosure of significant accounting policies in an orderly manner.
- To bring uniformity in the disclosure of accounting policies by different enterprises and ensure standards in the nature and degree of disclosure.
- Such disclosures facilitate more meaningful comparison between financial statements of different enterprises for the same accounting periods.

2. Fundamental Accounting Assumptions

There are certain accounting concepts, which are very fundamental to the process of preparation of Financial Statements.
AS-1 identifies three such Fundamental Accounting Assumptions:

Fundamental Accounting Assumptions

- Going Concern
- Consistency
- Accrual

2.1 Going Concern:

The enterprise is normally viewed as a going concern. The financial statements are normally prepared on the assumption that an enterprise will continue its operations in the foreseeable future and:

- Neither there is **intention,**
- Nor is there ***a* need**

of liquidation or of curtailing materially the scale of its operations.
Financial statements prepared on Going concern basis recognise:

- the need for sufficient retention of profit to replace assets consumed in operation, and
- for making adequate provision for settlement of its liabilities.

- If an enterprise is not a going concern, valuation of its assets and liabilities on historical cost becomes irrelevant and consequently it's profit or loss may not give reliable information.

Example:
The book value of 10% loan as on 31st March, 20X1 is Rs. 35,000. There is an early repayment penalty for the loan Rs. 2,500.
(i) Assuming Going Concern:
Liabilities will continue to be valued at book value only, Rs. 35,000.
(ii) Not Assuming Going Concern:
Liabilities will be valued at the settlement amount. So, the 10% loan will be shown in the Balance sheet at Rs. 37,500 (Rs. 35000 plus Rs. 2500 penalty for early repayment).

Example:
The cost and net realisable value of stock on 31st March, 20X1 were Rs. 32,000 and Rs. 40,000 respectively.
(i) Assuming Going Concern:
Stock will be valued at the valuation principle of "Cost or Net Realisable Value, whichever is lower". So, the stock will be shown in the Balance sheet at Rs. 32,000.
(ii) Not Assuming Going Concern:
Since, the entity is not a going concern, its assets will be valued at realisable value, Rs. 40,000.

2.2 Consistency:
For ensuring comparability for the benefit of bankers, creditors, Govt. and other users of financial information, it is necessary that there should be consistency in using accounting policy, i.e., using the same accounting policy for similar transactions.

2.2.1 Change in Accounting Policy
Situations may develop needing a change of accounting measurement adopted earlier. In such a situation, a departure from an accounting concept is permissible only by making a full disclosure about the:

- Change, and
- Monetary effect of the change on the financial statements.

Accounting policy can be changed if the change is required

- ***by a statute***
- ***by an AS***
- ***for more appropriate presentation***

2.3 Accrual basis of accounting:
This concept is the core of the mercantile system of accounting. Under this basis of accounting, transactions are recognised as soon as they occur, whether cash or cash equivalent is actually received or paid.

Advantages of using Accrual Basis of Accounting:

- Ensures better matching between revenue and cost.
- Profit / Loss reflects activities of the enterprise during an accounting period, rather than cash flows generated by it.

Limitation of using Accrual Basis of Accounting:

While accrual basis is a more logical approach to profit determination than the cash basis of accounting, it exposes an enterprise to the risk of

- recognising an income before actual receipt
- overstating the divisible profits and dividend decisions based on such overstated profit lead to erosion of capital i.e. dividens may be paid even if profits is not realised in cash.

For this reason, accounting standards require that no revenue should be recognised unless:

- the amount of consideration and
- actual realisation of the consideration

is reasonably certain.

Despite the possibility of distribution of profit not actually earned, accrual basis of accounting is generally followed because of its logical superiority over cash basis of accounting. Section 128(1)(iii) of the Companies Act, 2013 makes it mandatory for companies to maintain accounts on accrual basis only.

It is not necessary to expressly state that accrual basis of accounting has been followed in preparation of a financial statement. In case, any income/expense is recognised on cash basis, the fact should be stated subject to the materiality of the item.

Example:
(a) A trader purchased article A on credit in period 1 for Rs. 50,000.
(b) He also purchased article B in period 1 for Rs. 2,000 cash.
(c) The trader sold article A in period 1 for Rs. 60,000 in cash.
(d) He also sold article B in period 1 for Rs. 2,500 on credit.

(i) Cash basis of accounting:
Cash purchase of article B and cash sale of article A is recognised in period 1 while purchase of article A on payment and sale of article B on receipt is recognised in period 2.

(ii) Accrual basis of accounting:
Credit purchase of article A and cash purchase of article B and cash sale of article A and credit sale of article B is recognised in period 1 only.

3 Accounting Policies

3.1 Meaning:

The accounting policies refer to the:

- specific accounting principles and
- the methods of applying those principles

adopted by the enterprise in the preparation and presentation of financial statements.

3.2 Accountant's role:

For every item right from valuation of assets and liabilities to recognition of revenue, providing for expected losses, for each event, accountants need to**:**

- form principles
- and evolve a method to adopt those principles.

This method of forming and applying accounting principles is known as accounting policies.

3.3 Different Accounting Policies:

There is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate make alternative accounting principles acceptable.

3.4 Examples:

Items to be disclosed	Method of disclosure or valuation
Inventories	FIFO, Weighted Average etc.
Cash Flow Statement	Direct Method, Indirect Method
Depreciation	Straight Line Method, Reducing Balance Method, Units of Production Method etc.
Valuation of Investments	Current Investments: At Cost or Market Value, lower Non-Current Investments: At Cost
Valuation of Fixed Assets	Cost Model, Revaluation Model.
Government Grants	Income Approach or Capital Approach

4 Selection of Accounting Policy

4.1 Primary Consideration:

The primary consideration is that the Financial Statements prepared and presented should represent a "True and Fair" view as under: -

In case of balance sheet – **of the state of affairs of the enterprise on a certain date**
In case of Profit & Loss A/c – **of the performance of enterprise for the period ended on that date**

4.2 Other Major Considerations:

AS – 1 identifies the following "three major considerations" for selecting accounting policies:

Considerations for selecting an Appropriate Accounting Policy

- Prudence
- Substance over form
- Materiality

4.2.1 Prudence:

Prudence is inclusion of a degree of caution while making estimates made under uncertainty.

- Probable profits are not anticipated. Profits are recognized only when they are realised in cash or a third party has legally become liable to pay the amount, but
- Probable losses are provided for as a matter of conservatism. Provision should be created for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

Example:
Provision for doubtful debts, Provision for discount on debtors, policy of valuing inventory at lower of cost and net realisable value etc.

Caution while applying the concept of Prudence:

It does not allow creation of hidden reserves by:

- understating profits and assets or
- overstating liabilities and losses.

Example: Suppose a company is facing a damage suit. No provision for damages should be recognised by a charge against profit, unless the probability of losing the suit is more than the probability of not losing it (i.e > 50% chance of losing)

4.2.2 Substance Over Legal form:

Transactions and other events should be accounted for and presented in accordance with their substance and financial reality and not merely by their legal form.

Example: (You will understand this in AS-19 leases)
Suppose a company has building under a finance lease of 50 years which is also the useful life. In such a finance lease, though the lessor continues to be legal owner of the asset, he is essentially transferring the risk and reward incidental (attached) to the ownership of the asset to the lessee.

Lessee is using the asset for generating revenue, and hence the asset is recognized in his books. Thus, the Balance sheet of lessee reflects assets taken on lease and corresponding liability towards the lessor on account of lease payments. Depreciation on such assets is debited to the lessee's Profit and Loss Account.

Similarly, in case of an asset acquired on Hire Purchase, ownership is not transferred till the last instalment is paid. However, the asset is shown in the books of the Hire Purchaser.

4.2.3 Materiality:

Financial statements should disclose all 'material items', i.e., the items the knowledge of which might influence the economic decisions of the users of the financial statement.
Materiality is not always a matter of relative size.

Example:
A small amount lost by fraudulent practices of certain directors can indicate a serious flaw in the enterprise's internal control system requiring immediate attention to avoid greater losses in future.

In certain cases, quantitative limits of materiality are specified. A few of such cases (From general Instructions for preparation of Statement of Profit and Loss in Schedule III to the Companies Act, 2013) are given below. A company should disclose in Notes to Accounts:

- Additional information regarding any item of income or expenditure which exceeds:
  - 1% of the revenue from operations or
  - Rs. 1,00,000,

  whichever is higher.
- Shares in the company held by each shareholder holding more than 5 per cent shares specifying the number of shares held.

5 Disclosure Requirements

Accounting Policies should be disclosed in the Financial Statement for the following reasons:

1. Better Understanding of Financial Statements.
2. Inter-Firm Comparison.
3. Compliance with the Companies Act, 2013.
4. ICAI also provided guidelines for disclosure of significant accounting policies.

5.1 Manner of disclosure:

All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

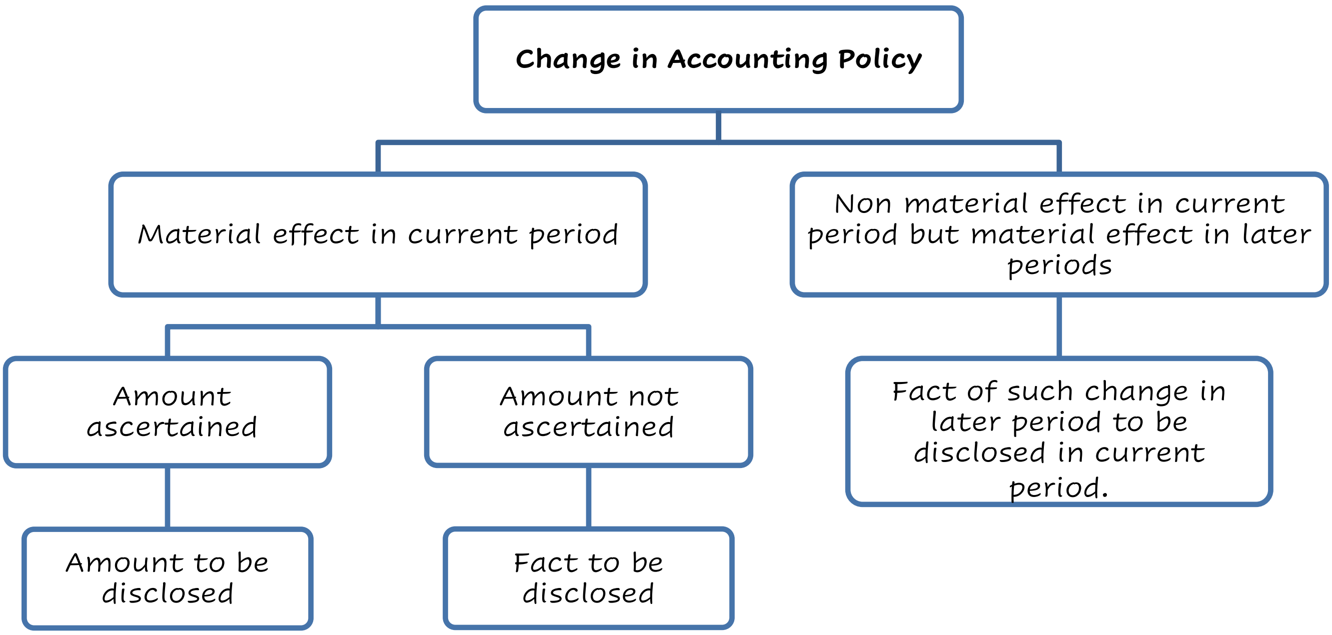
5.2 Place of disclosure:

The disclosure of the significant accounting policies as such should form part of the financial statements and the significant accounting policies should normally be disclosed in one place, instead of being scattered over several Statements, Schedules, and Notes.
Note: Being a part of the financial statement, the opinion of auditors should cover the disclosures of accounting policies.

5.3 Disclosure of Changes in Accounting Policies:

Any change in the accounting policies which:

- has a material effect in the current period, or
- is reasonably expected to have a material effect in a later period should be disclosed.



Example: (Change having material effect in current year)
In the books of M/s Prashant Ltd, closing inventory as on 31.03.20X2 amounts to Rs. 1,63,000 (on the basis of FIFO method). The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 20X1-X2.
Based on weighted average method, closing inventory as on 31.03.20X2 amounts to Rs. 1,47,000. Realisable value of the inventory as on 31.03.20X2 amounts to Rs. 1,95,000.
Prashant Ltd. should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose the change in accounting policy in the following manner:
"The company values its inventory at lower of cost and net realisable value. Since net realisable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e., 201X1-X2, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by Rs. 16,000. "

Example: (Change having material effect in future years)
Suppose a company makes provision for warranty claims based on estimated costs of materials and labour. The company changed the policy in 20X1-X2 to
include overheads in estimating costs for servicing warranty claims. If the value of warranty sales in 20X1-X2 is not significant, the change in policy will not have any material effect on financial statements of 20X1-X2. Yet, the company must disclose the change in accounting policy in 20X1-X2 because the change can affect future accounting periods when value of warranty sales may rise to a significant level.
If the disclosure is not made in 20X1-X2, then no disclosure in future years will be required. This is because an enterprise must disclose changes in accounting policies in the year of change only.

5.4 Disclosure of deviations from fundamental accounting assumptions:

If the fundamental accounting assumptions, viz.

1. Going concern,
2. Consistency and
3. Accrual

are followed in financial statements, specific disclosure is not required.
If a fundamental accounting assumption is not followed, the fact should be disclosed.

AS - 2
Inventories

1.Introduction

1.1 Objective

- To prescribe accounting treatment of inventories.
- Determination of cost of inventory.
- Subsequent recognition as an expense.
- Provides guidelines on cost formulas.

1.2 Scope

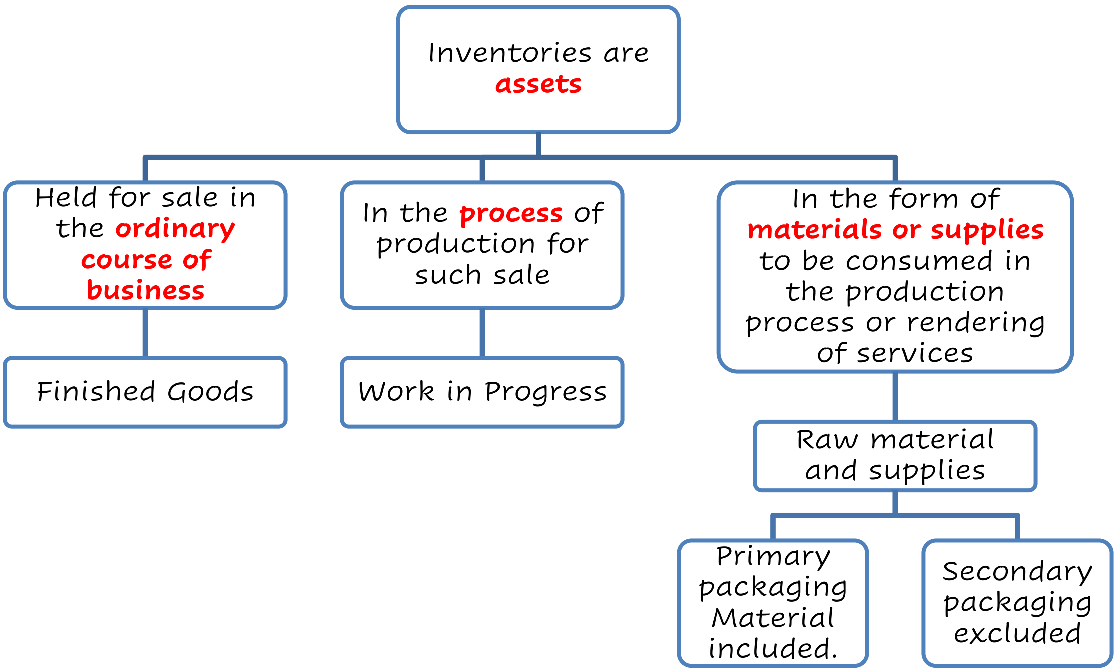
Standard applies to all inventories except

(a)	WIP arising out of Construction Contracts
(b)	WIP arising in the ordinary course of service providers
(c)	Shares, Debentures and other financial instruments
(d)	Producer's inventory of livestock, agricultural products, forest products and mineral oils, ores, gases to the extent that they are measured at NRV in accordance with well established practices in those industries.

Inventory does not include spare parts, servicing equipment & standby equipment which meets the definition of AS 10 PPE (Property, Plant & Equipment)

2. Definitions

Inventories



Net Realisable Value (NRV)

NRV is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated costs necessary to make the sale.

3. Measurement

Golden Rule - Inventories are measured at lower of cost and net realisable value.

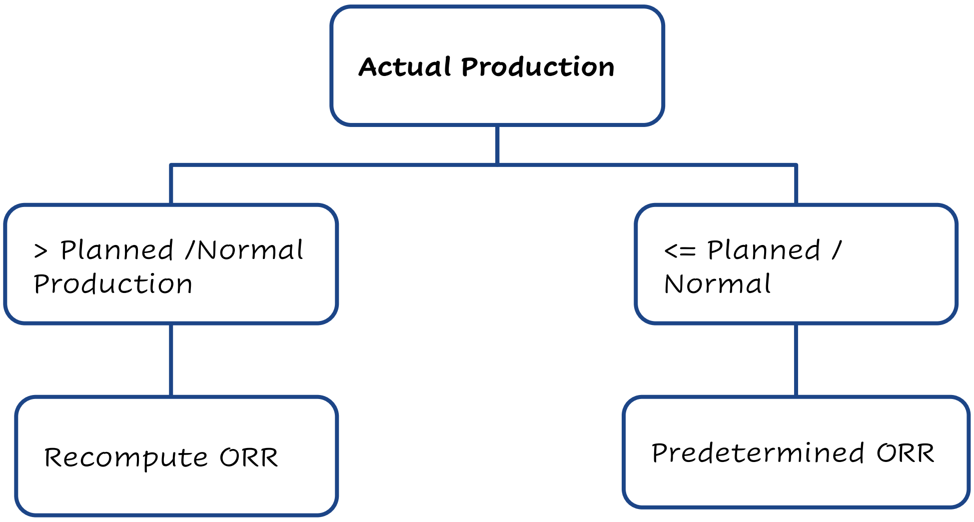
Cost of Inventories

PARTICULARS	AMOUNT	
Cost of Purchases		
Purchase Price	XXX	
(+) Import duties & other taxes	XXX	
(+) Transport & handling charges	XXX	
(+) Other Costs to bring the inventory to present	XXX	
location & condition	XXX	
(-)Trade discounts, rebates & other similar items	(XXX)	XXX
Cost of Conversion		
(+) Direct labour		
(+) Other direct costs	XXX	
(+) Overheads (Fixed* as well as variable	XXX	
overheads)	XXX	XXX
Other Costs		
Costs incurred to bring the inventories to their		
present location & condition	XXX	
(+) Borrowing Cost under AS 16	XXX	XXX
Cost of Inventory		**XXX**

Overhead

Fixed overhead (FOH) is allocated based on a predetermined overhead recovery rate (ORR) computed as below.

Predetermined ORR = Budgeted FOH / Planned or Normal Production



Net Realisable Value

Estimated Selling Price	XXX
(-) Estimated costs to complete	(XXX)
(-) Estimated Costs to Sell	(XXX)
Net Realisable Value	XXX

- Estimates of NRV should be based on the most reliable evidence available.
- Events occuring after the balance sheet should be considered to the extent they provide additional evidence of events existing on balance sheet date.
- Price reductions in future should not be considered to determine NRV.

- If inventory is held for a firm contract to sell, the contracted price can be an evidence of NRV.

Write down of inventories should be done on an item to item basis and not on global basis.

4. Joint Products & By Products

Joint Products – Two or more products produced from a single process using common inputs. Each product has significant value. Example – Petrol, Diesel, Gas produced on refining crude. Joint costs are allocated on the basis of relative sales value / NRV at split off points.

By Products – Secondary or incidental products in the process of manufacture generally have an insignificant value , considered as scrap.
NRV of by products is reduced from joint costs if the by products are immaterial. If the by-products are material, consider them as Joint Products.

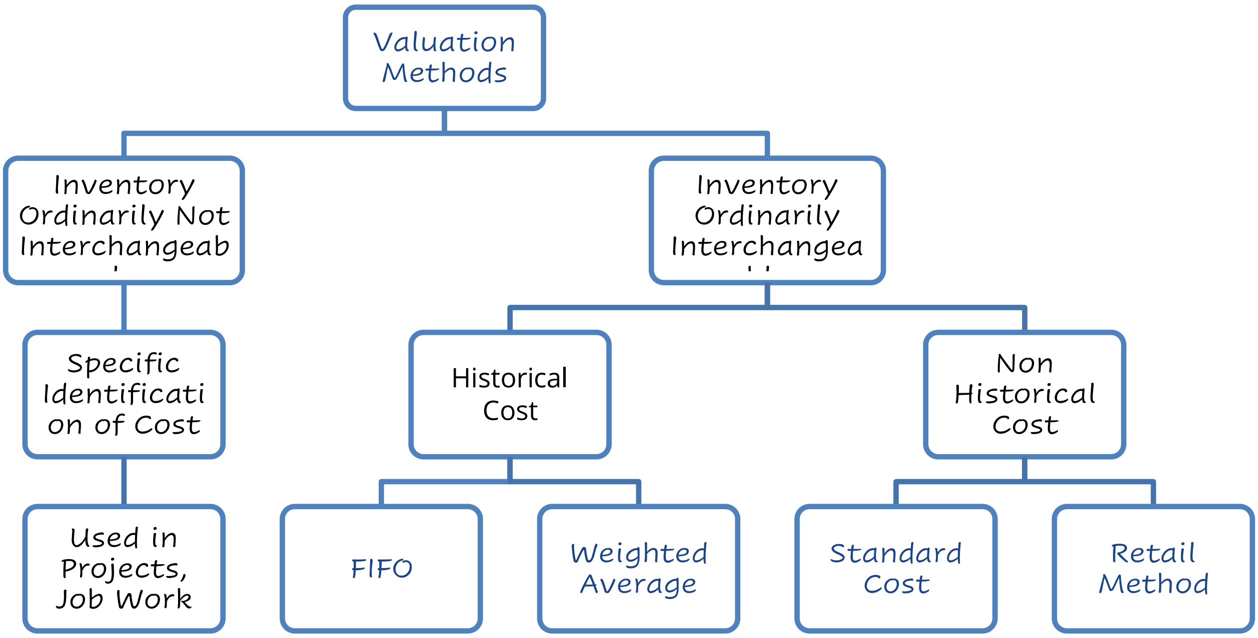
Example:
During the production of main product Bomex , a By product Brusil is also produced. Total cost of conversion is Rs. 3,88,500. 12500 units of Bomex and 7000 units of Brusil arise from the process. Brusil cannot be sold at the time of split off.It can be sold after a processing. Cost of further processing is Rs.0.5 , by product can be sold for Rs. 6 per unit. Calculate cost of conversion of Bomex which is the main product.

Sale value of Brusil	Rs. 6
Less: Processing Cost	Rs. 0.5
NRV at splitoff	Rs. 5.5
Total NRV	7000 x 5.5 = Rs. 38,500
NRV of by products should be reduced form joint cost	
Total cost of conversion	3,88,500
Less: NRV of by product	38,500
Cost of Conversion of Bomex	Rs. 3,50,000
Cost of conversion per unit	Rs. 3,50,000/12,500 = Rs. 28 per unit

Cost measurement techniques

Retail Method	Standard Cost Method
Cost of Inventory = Expected Sales Value (-) Normal Gross Profit Margin	Standard cost is set considering standard usage of - Material - Labour - Overhead - Capacity utilisation

Cost formula



An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different use , different cost formulas can be used.

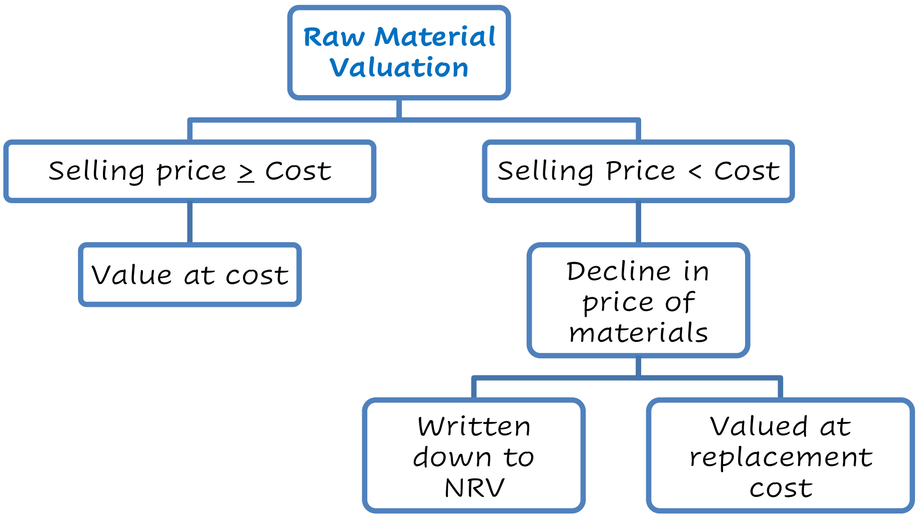
FIFO Method

- Assumption of cost flow : Inventory purchased first is sold first.
- Goods in Inventory are valued using the latest rates

Weighted Average Rate

- Cost is determined using a weighted average rate of goods received.
- The weighted average can be a periodic weighted average or a moving weighted average.

Raw Material Valuation



5. Disclosures

- Accounting policies including cost formula used.
- Analysis of carrying amount of inventory & carrying amount in classifications appropriate to the entity
    - Raw materials and components
    - WIP
    - Finished Goods

- Stock in trade
- Stores and spares
- Loose Tools
- Others

AS 10
PROPERTY, PLANT AND EQUIPMENT

1.Introduction

1.1 Objective

- To prescribe accounting treatment of property, plant and equipment.
- Recognition of assets.
- Determination of carrying amount and depreciation charges
- Depreciation, retirement and disposal accounting.

1.2 Scope

PPE are generally grouped into various classes like **land and buildings, machinery, ships, aircrafts, furniture, bearer plants etc.**

This standard does NOT deal with the following.

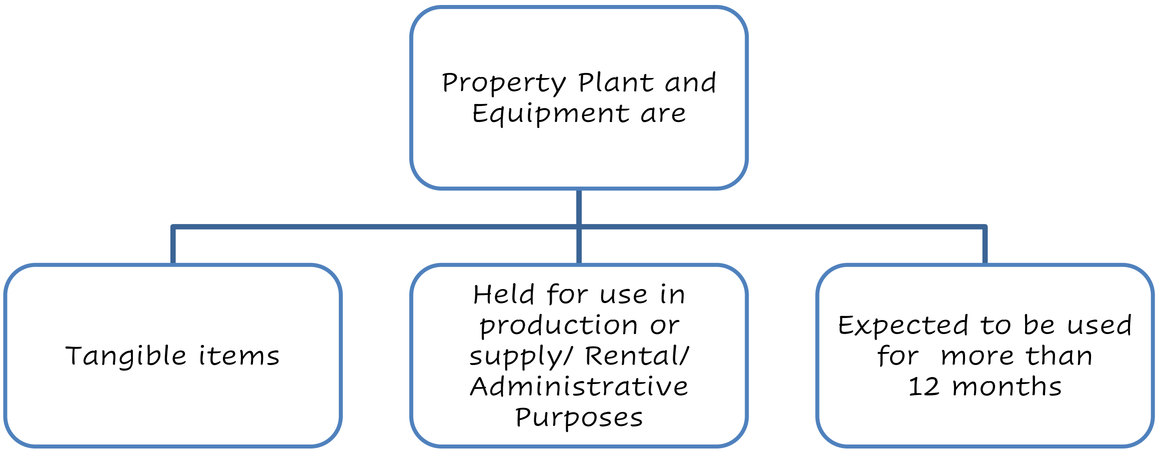
(a) Biological assets related to agricultural activity other than bearer plants

(b) Wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources However, this standard applies to PPE used to develop and maintain above assets.

(c) Investment Property, as defined in AS 13, should be accounted for only in accordance with the cost model prescribed under this standard.

2.Definitions

2.1. Property,Plant and Equipment



2.2. Bearer Plant

Bearer plant is a living plant that

(a) Is used in the production/supply of agricultural produce

(b) Is expected to bear produce for more than a period of twelve months

(c) Has a remote likelihood of being sold as an agricultural produce, except for incidental scrap sales.

2.3. Carrying Amount

Gross Book Value	xxx
(-) Accumulated Depreciation	xxx
(-) Accumulated Impairment Loss (AS 28)	xxx
Carrying Amount	**xxx**

3. Recognition

General Criteria for recognition of PPE

- Probable that future economic benefits associated with the item will flow to the entity
- Cost of item can be measured reliably

Spare parts, stand-by equipment, and servicing equipment:
Recognised in accordance with this standard when they meet the definition of PPE. Otherwise, such items are classified as inventory (AS 2) and charged to the statement of profit or loss when it is issued for usage.

Aggregation of individually insignificant items:
It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the recognition criteria to the aggregate value.

Other important points:
Items of PPE may be acquired for safety or environmental reasons. These may be necessary for an entity to obtain the future economic benefits from its other assets. (Indirect benefits) Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets more than what could be derived had those items not been acquired.

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

4. Amount to be capitalised is based on the nature of consideration paid for the asset.

Asset is acquired by

- Payment by cash/ for credit
- Self-Construction
- Exchange of Non monetary assets

If an asset is purchased by payment of cash or credit.
The cost of an item of PPE comprises

Purchase Price	xxx
Add:	
Non-refundable taxes and duties	xxx
Initial delivery and handling charges	xxx
Cost of site preparation	xxx

Installation & Assembly costs	xxx
Professional Fees	xxx
Borrowing costs (If permitted by AS 16)	xxx
Costs of testing (After deducting proceeds from sale of any product produced during testing)	xxx
Present Value of Decommissioning, restoration costs	xxx
Any directly attributable cost to bring the asset to the location and condition, necessary to operate for its purpose intended by the management	xxx
Less:	
Government grant received specific to the asset	xxx
Trade discounts and rebates (If included in above costs)	xxx
Cost of PPE to be capitalised	**xxxx**

Exclusions from Cost of PPE

(a) Costs of conducting business in a new location or with a new class of customer (including costs of staff training)
(b) Costs incurred in introducing a new product or service.
(c) Cost of opening a new facility
(d) Administrative and other general overhead costs

> The income and related expenses of incidental operations are recognised in profit or loss account

Self – Constructed PPE

The cost of a self-constructed asset is determined using the same principles as for an acquired asset.

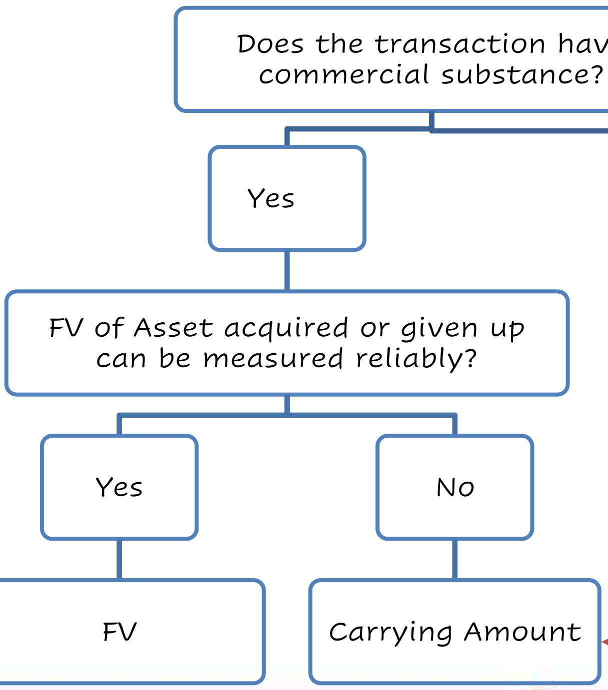
Inclusions:

- Costs of construction that directly relate to the specific assets
- Costs that can be attributable or allocated to the construction activity.
- Borrowing costs if PPE is a qualifying asset as per AS 16

Exclusions:

- Internal profits (Always take cost of construction and not sale price)
- The cost of abnormal amounts of wasted material, labour , or other resources incurred in self-constructing an asset.

PPE is acquired by exchange of non-monetary assets



If both the above conditions are satisfied, PPE is measured at
(a) FV of asset given up (1st Priority)
(b) FV of asset acquired (If this is more evident, use this)

If above conditions are not satisfied, PPE is measured carrying amount of the asset given up.

Commercial Substance:

An exchange transaction has commercial substance if:

(a) The risk, timing, and amount of the cash flows of the asset received are significantly different from the cash flows of the asset transferred.

(b) There is a significant effect on the present value of the after tax cash flows that an entity expects to arise from the continuing use and disposal of the asset due to exchange transactions.

Fair Value of the Asset:

The fair value of an asset is reliably measurable if:

a) The variability in the range of reasonable fair value measurements is not significant for that asset

b) The probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value.

Cost of Bearer Plants

All the cost of activities necessary to cultivate the bearer plants before they are in the location and condition necessary to be capable of operating in the manner intended by management.

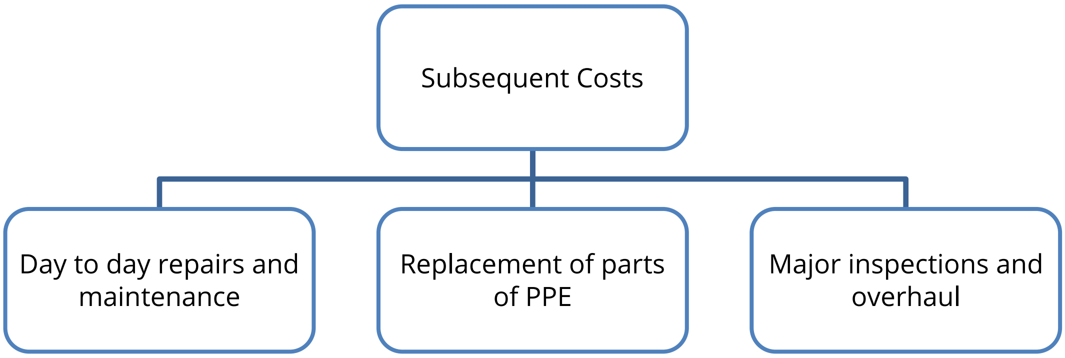
5. Cessation of Capitalisation

Recognition of costs to carrying amount of PPE ceases when the item is in the

- location and
- condition
- necessary for it to be capable of operating in the manner
- intended by management.

For Example, Initial operating losses, cost of relocating or reorganising entity's operations are not included in the cost of PPE.

6. Subsequent Costs



Situation	Treatment as per AS 10
Repair and maintenance (day-to-day servicing)	Expense in **Profit or Loss** as incurred.
Expenditure that increases life or efficiency beyond originally assessed life/efficiency	**Capitalised** as part of asset cost.
Replacement of parts of PPE	- Derecognise carrying amount of replaced part.

	- Capitalise cost of new part (if recognition criteria are met).
Major inspections / overhauls	- Cost of inspection is **capitalized if recognition criteria met**; - carrying amount of any earlier inspection cost is **derecognised**. - The inspection costs are recognised irrespective of whether the cost of the previous inspection was identified at time of initial recognition - The estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

.

7. Special Considerations

Case	Accounting for PPE
Payment is deferred beyond normal credit terms	**Cash price Equivalent.** Difference between payments and cash price equivalet is considered as interest expense (AS-16)
PPE Purchased for consolidated price	Allocate the transaction price based on **respective FV of the assets**.
PPE Held by lessee under a finance lease	Apply principles of AS – 19 Lower of FV or PV of MLP
Government Grants related to PPE	Government grant **may be reduced from cost** of Fixed Asset as per AS-12

8. Depreciation

The depreciable amount of an asset should be allocated on a systematic basis over its useful life.

Historical cost/ Revalued Amount	xxx
Less: Estimated residual value	xxx
Depreciable Amount	xxx

The depreciation charge for each period should be recognised in the statement of profit and loss unless it is included in the carrying amount of another asset.

Commencement of Depreciation	**When the asset is available to use.** i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management.
Cessation of Depreciation	**Ceases at the earliest of** (a) Asset is retired from active use and is held for disposal (b) Date that the asset is derecognised.

Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.

Component Accounting for depreciation

- An asset may consist of different and significant physical components.
    - If an item of PPE comprises two or more significant components, with substantially different useful lives, usage, or flow of economic benefits,
    - then each component should be recognised and depreciated separately over its individual useful life.
- When a significant component is replaced or restored, the old component is derecognised, and the cost of the new component is capitalised.

Land and buildings are separable assets and are accounted for separately, even when they are acquired together.

- If the cost of land includes the costs of site dismantlement, removal, and restoration, that portion of the land asset is depreciated over the period of benefits obtained by incurring those costs.
- A combination of more than one depreciation method is sometimes used depending upon type, nature of circumstances for significant parts one PPE.

For Example: Entity can follow WDV method for aircraft engine whereas SLM for aircraft body.

In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits to be derived from it.

Factors Determining Depreciable Amount

Factors determining depreciation

- Historical Cost/ Revalued amount
- Useful Life
- Residual Value

Useful life of an asset –

Useful life is

(a) the period over which an asset is expected to be available for use by an entity

(b) the number of production or similar units expected to be obtained from the asset by an entity.

The following factors are considered in determining the useful life of an as

- Expected usage of the asset.
- Expected physical wear and tear (Depends on operational factors)
- Technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.
- Legal or similar limits on the use of the asset.

> The useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets

Residual Value

- It is an estimated amount, which can be recovered from the asset at the end of its useful life.
- Residual value is a current estimate based on similar assets which would have reached the end of their useful life.
- The estimation is made by the management at the time of acquisition. If the estimated residual value is insignificant, the value is considered as NIL.

> The residual value and the useful life should be reviewed at least at the end of financial year. Any change from expectations should be accounted for as a change in an accounting estimate in accordance with AS 5.
>
> The remaining depreciable amount should be depreciated over the remaining revised useful life.

Different scenarios

- Residual value >= Carrying amount → Depreciation charge = zero
- Fair value > Carrying amount → Depreciation charged

Depreciation

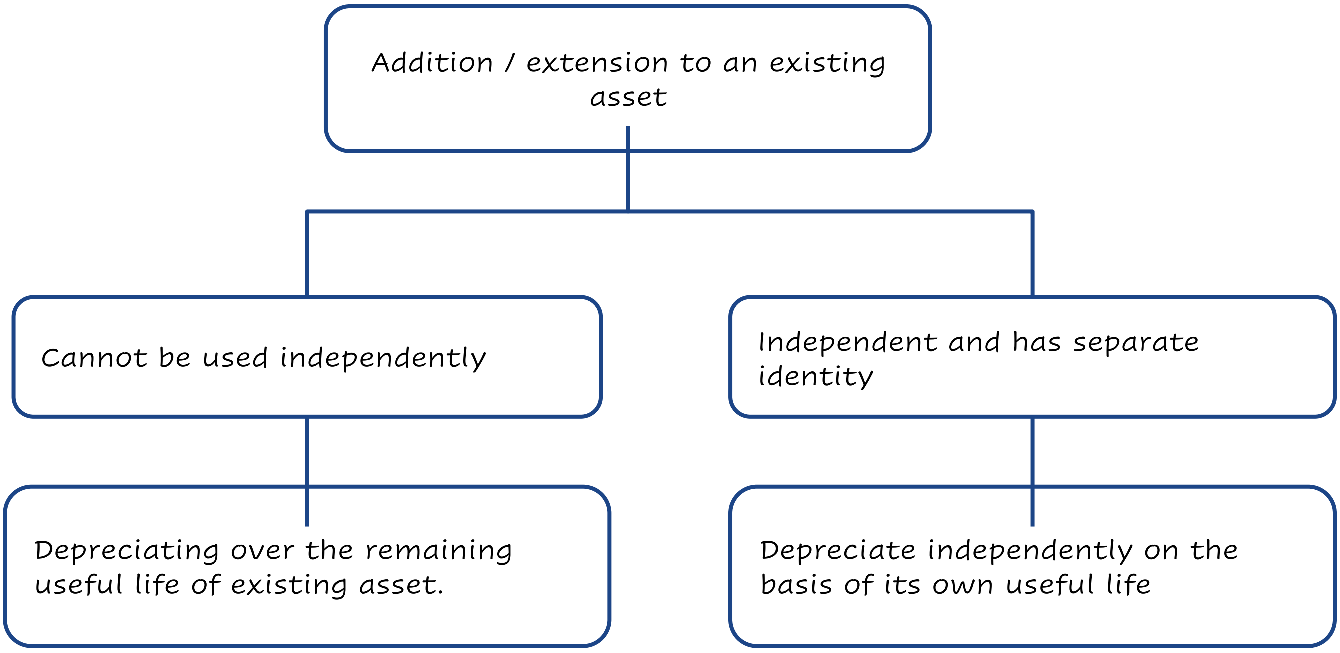
The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

For Example:

Straight line depreciation	Constant charge over the useful life
Diminishing Balance Method	Decreasing charge over the useful life
Units of Production method	Charged based on expected use or output

- The management should consider true & fair view, prudence, substance over form and materiality while selecting depreciation method.
- Depreciation charge can be zero if the entity follows number of units production basis for depreciation and if no production happens in a particular year. (But needs to test for impairment as per AS 28)
- Depreciation method should not be based on ratio of revenue as revenue generated depends upon demand, supply, inflation, sales volume, and prices

Depreciation of an addition/ extension to an existing PPE



9. Impairment

Entity must calculate the recoverable amount in accordance with AS 28. Impairment means a type of loss which is recognised. Don't worry you will learn about it in detail in AS 28!

Compensation from third parties for items of PPE that were impaired, lost or given up shall be included in profit or loss when the compensation becomes receivable.

10. Measurement After recognition

Cost Model

Initial Cost	xxx
(-) Accumulated Depreciation	xxx
(-) Accumulated Impairment Loss	xxx
Carrying Amount	**xxx**

Revaluation Model

Fair Value at the date of revaluation	xxx
(-) Subsequent Accumulated Depreciation	xxx
(-) Subsequent Accumulated Impairment Loss	xxx
Carrying Amount	**xxx**

Revaluations are required to be carried out with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

Frequency of revaluations

The frequency of revaluations depends upon the changes in fair values of the items of property, Plant and equipment being revalued.

If PPE experiences significant and volatile changes in fair value, there must be annual revaluation. Otherwise, it may be necessary to revalue the item only every three or five years.

Accumulated Depreciation at the date of revaluation

Treatment

- Depreciation elimination approach
  - Accumulated depreciation is eliminated against the gross carrying amount
- Restatement approach
  - Restated proportionately with the change in carrying amount

Limit on Revalued Amount –
The revalued amount should not be more than the recoverable amount (AS 28)

Revaluation to be made for the entire class of assets – Revaluation should be performed for an entire class of PPE.

For Example: If the entity takes a decision to revalue its buildings, it should revalue all the buildings of the entity. i.e., revaluation of selective assets within a class is not permitted.
The entity can divide the PPE into classes based on the nature of items such as land, land and buildings, machinery, ships, aircraft, motor vehicles, furniture and fixtures, office equipment, bearer plants.

Class of assets (Building)	Valuation model
2 Office buildings	Cost model
5 Factory buildings	Revaluation model

First Time Revaluation:

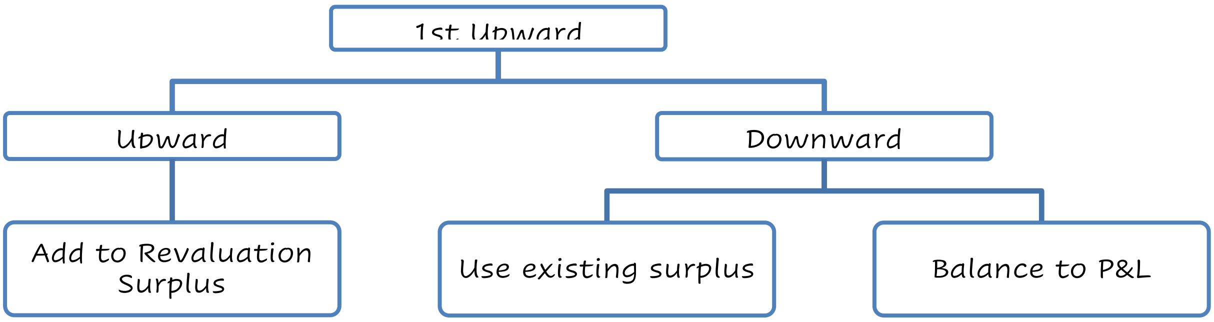
First time revaluation

- Upward Revaluation – Gain
  - Should be credited to owner's interest under Revaluation Surplus
- Downward Revaluation – Loss
  - Charged to profit and loss a/c

Upward Revaluation	PPE A/c To Revaluation Surplus A/c	**Dr**
Downward Revaluation	Profit & Loss A/c To PPE A/c	**Dr**

Subsequent Revaluation:

(a) If first time is upward revaluation



Subsequent upward revaluation

Further increase should be credited directly to owner's interests under the heading revaluation surplus

PPE A/c **Dr**

To Revaluation Surplus A/c

Subsequent downward revaluation

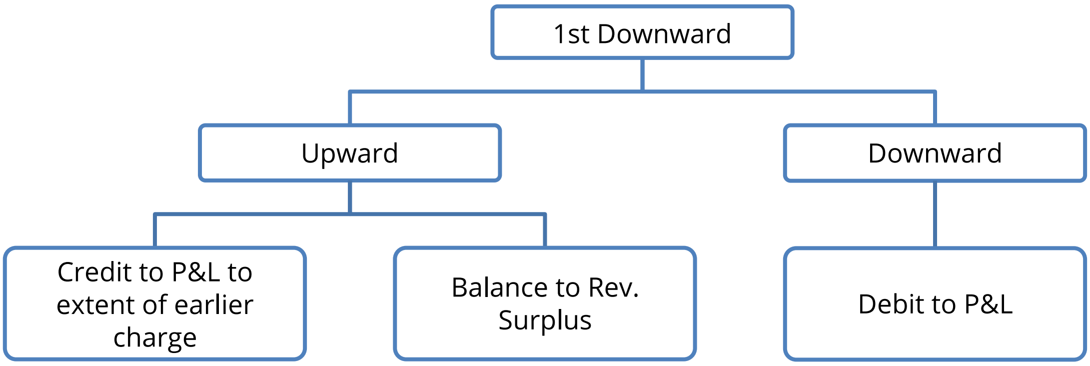
Utilise the available revaluation surplus and remaining balance should be charged to the statement of profit and loss.

Revaluation Surplus A/c **Dr**

Statement of Profit & Loss A/c **Dr** (Balancing Figure)

To PPE A/c

(a) If first time is downward revaluation



Subsequent downward revaluation

Further decrease should be transferred to the statement of profit and loss.

Profit and Loss A/c **Dr**

To PPE A/c

Subsequent upward revaluation

Credit the statement of profit and loss to the extent it was charged in earlier revaluation and the remaining balance should be accumulated in equity under revaluation surplus.

PPE A/c **Dr**
To Profit & Loss A/c (To the extent charged earlier)
To Revaluation surplus (balancing Figure)

> The effects of taxes on revaluation are recognised and disclosed as per AS 22

Treatment of Revaluation Surplus:

Treatment of Revaluation Surplus

Option 1 -
The revaluation surplus may be transferred directly to retained earnings when the asset is derecognised.

Option 2 -
The surplus may be trasnferred as the asset is used by an entity.

Surplus = Depreciation based on the revalued carrying amount of the asset **(-)** Depreciation based on the asset's original cost

> Transfers from revaluation surplus to retained earnings are not made through profit or loss.

Changes in Existing Decommissioning Restoration & Similar Liabilities

The following events change the measurement of an existing decommissioning, restoration or similar liability should be accounted for:

a. A change in the estimated outflow of resources embodying economic benefits required to settle the obligation
b. A change in the current market-based discount rate
c. An increase that reflects the passage of time (unwinding of the discount)

If related asset is measured using cost model:

i. Changes in liability shall be added to or deducted from the cost of the asset in the current period and related provision is adjusted accordingly.
ii. Decrease in liability cannot exceed the carrying amount of the asset.

> If Decrease in Liability > Carrying Amount, excess is recognised as income

iii. If changes in liability results in addition to the cost of PPE, consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, test for impairment as per AS 28 and account for impairment loss.

If related asset is measured using Revaluation model: Treat changes as if the asset is revalued

i. Any increase in liability is adjusted against revaluation surplus (to the extent of balance available). Any excess is recognised in the statement of profit and loss
ii. Any decrease in liability is recognised in the revaluation reserve. If any revaluation deficit is charged to profit and loss in the prior periods, to that extent, it is recognised as income in the statement of profit and loss.

> If Decrease in Liability > Carrying Amount, excess is recognised as income in the statement of profit and loss

iii. Any change in liability would require the asset to be tested for impairment to ascertain if there is any change in fair value.

Common points for both cost and revaluation model:

- The adjusted depreciable amount of the asset is depreciated over its useful life.
- Once the related asset has reached the end of its useful life, all subsequent changes in the liability shall be recognised in profit or loss as they occur.
- The periodic unwinding of the discount shall be recognised in profit or loss as a finance cost, as it occurs. Capitalisation under AS 16 is not permitted.

11. Derecognition

The carrying amount of an item of property, plant and equipment should be derecognised
(a) on disposal
(b) When no future economic benefits are expected from its use or disposal.

The gain or loss arising from the derecognition of an item of property, plant and equipment is included in profit or loss when the item is derecognised.

Transfers from revaluation surplus to general reserve should not be made through statement of profit and loss.

> Gain/Loss from derecognition of PPE = Net disposal proceeds – Carrying Amount.Gains shall not be classified as revenue.

In determining the date of disposal of an item of PPE, an entity applies the criteria in AS 9 for recognising revenue from the sale of goods.

12. Disclosure

The financial statements should disclose, for each class of property, plant and equipment:
(a) the measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount
(b) the depreciation methods used
(c) the useful lives or the depreciation rates used. In case the useful lives or the depreciation rates used are different from those specified in the statute governing the enterprise, it should make a specific mention of that fact
(d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period
(e) a reconciliation of the carrying amount at the beginning and end of the period showing additions:
    - assets retired from active use and held for disposal
    - acquisitions through business combinations
    - increases or decreases resulting from revaluations and from impairment losses recognised or reversed directly in revaluation surplus in accordance with AS 28

- impairment losses recognised in the statement of P&L in accordance with AS 28
- impairment losses reversed in the statement of P&L in accordance with AS 28
- depreciation
- 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
- other changes.

The financial statements should also disclose:

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

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

(c) the amount of contractual commitments for the acquisition of property, plant and equipment

(d) 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

(e) 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

(a) the effective date of the revaluation

(b) whether an independent valuer was involved

(c) the methods and significant assumptions applied in estimating fair values of the items

(d) 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

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

(f) Disclosure of the methods adopted and the estimated useful lives or depreciation rates.

(g) Disclosure as per AS 5, if applicable.

(h) Information on impaired PPE

Voluntary disclosures :

- Carrying amount of temporarily idle property, plant and equipment.
- Gross carrying amount of any fully depreciated PPE that is still in use.
- For each revalued class of PPE, the carrying amount that would have been recognised had the assets been carried under the cost model.
- The carrying amount of PPE retired from active use and not held for disposal

AS – 12
Accounting for Government Grants

1 Introduction

1.1 Importance

The receipt of government grants is important for preparing financial statements for two reasons:

1. **It is not a normal or recurring source of income**, so the enterprise must use the correct accounting method to record it.
2. **It helps show how much the enterprise has actually benefited from the grant during the year.** This makes it easier to compare the financial statements with previous years and with other companies.

1.2Definitions :

Government refers to:

- State and Central Government,
- Government agencies and similar bodies (like cantonments and development agencies),

whether local, national, or international.

! **Government Grants** are

- **assistance** by the government in **cash or kind**
- to an enterprise
- for **past or future compliance** with **certain conditions**.

! **1.2.1 Exclusions from the Scope**

Item Excluded	Reason / Explanation	Example
1. Government assistance which cannot be valued reasonably	AS 12 applies only when the benefit can be measured reliably.	Free technical advice, general promotional support.
2. Transactions which are normal trading transactions	Transactions with the government cannot be distinguished from the normal trading transactions_of the enterprise	Government purchases goods from companies
2. Government participation in ownership	Equity infusion is treated as capital contribution, not as a grant.	Government buying shares of a company to obtain ownership.
3. Assistance not related to operating activities	Benefits that are general in nature and not specific to the entity's operations fall outside AS 12.	Industrial policies available to all units in a backward region.
4. Tax concessions, tax holidays, investment allowances	These fall under taxation standards (AS 22), not AS 12.	Accelerated depreciation, tax exemptions, investment allowance.

⚠ ***As per opinion of expert advisory committee, the sales tax related exemption are considered as government grant.***

2 Accounting Treatment

2.1 Recognition of Government Grants:

! A government grant **should be recognised only when there is reasonable assurance** that:

- The enterprise **will comply with all the conditions** attached to the grant; and
- The grant will **actually be received**.

⚠Simply receiving the grant money does **not** prove that the enterprise has met, or will meet, the required conditions. I

Example: X Ltd applies for a grant from the local authority for a social initiative. The company must satisfy certain conditions to qualify. Although X Ltd expects to receive the grant in due course, there is a possibility that it may not be able to meet all the required conditions. In this situation, **X Ltd should not recognise the grant** in its books until it has reasonable assurance that it will be able to fulfil **all** the conditions attached to the grant.

Conditions to be Complied

- Past Conditions
  - Reasonable assurance not required as these are complied before receiving the grant
- Futute Conditions
  - Reasonable assurance required for compliance

2.2Accounting Treatment of Government Grants:

Two broad approaches

- Capital Approach
  - Grant is treated a part of **shareholders funds**
- Income Approach
  - Grant is taken to **income** over one or more periods.

3. Types of Government Grants

Types of Grants

- Non Monetary Government Grants
- Grants related to Specific Fixed Assets
- Grants related to Revenue
- Grants of the nature of Promoter's Contribution

3.1 Non-Monetary Government Grants

Government grants can also be received in the form of **non-monetary assets**, such as land, buildings, or machinery.

3.1.1 Grants at Concessional Rates

When the asset is given at a concessional (discounted) price, **the asset is recorded at its actual acquisition cost**.

Example:
If land in an industrial park is allotted for **₹10 lakh** while its market value is **₹50 lakh**, the land is recorded in books at **₹10 lakh**.

3.1.2 Grants Received Free of Cost

When the asset is received **free of cost**, it is recorded at a **nominal value** (e.g., ₹1) only for identification and control purposes.

Example:
If machinery is received free of cost as a grant, it is recorded at a nominal amount.

Entry required:
Machinery A/c .... Dr.
    To Provision for Depreciation A/c
(Being an asset recorded at a nominal value.)

Example:
Santosh Ltd. received land free of cost from the State Government, but it has not recorded it at all in the books. The company argues that:

(a) No money has been spent by the Company on its acquisition
(b) Land is not a depreciable asset

As per AS – 12, this treatment is not correct. Even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value for the purpose of identification and control. Whether it is depreciable or non-depreciable is not relevant in this regard.

3.2 Grants related to Specific Fixed Assets:

Grants related to specific fixed assets are government grants with conditions that

- An enterprise qualifying for them should **purchase, construct, or otherwise acquire such assets.**

- Restrict the type or location of the assets or the periods during which they are to be acquired or held.

Example:
Sagar Ltd. has received a grant of Rs. 8 crores from the Government for setting up a plant and machinery in a backward area. Out of this grant, the company distributed Rs. 2 crores as dividend.
As per AS - 12, when a government grant is received for a specific purpose, it should be utilised for the same. So, the grant received for constructing a plant and machinery is not available for distribution of dividend.

Methods of Presentation of Grants related to Fixed Assets:
The accounting treatment depends on whether the fixed asset is a depreciable asset or a non-depreciable asset.

3.2.1 Depreciable Fixed Assets

Grant related to Depreciable Assets

- Alternate I
  Deferrred Income
  - Transfer to P&L systematically on basis of depreciation
- Alternate II
  Reduce from Cost of Asset
  - Depreciation charged on reduced value

Example: Accounting for Grant received in Cash Rs.10 lakhs for purchase of Asset

Scenario	Approach I – Deferred Income Approach	Approach II – Capital Approach (Net-Off)
Asset Purchase Entry	Asset A/c Dr. ₹30 To Bank A/c ₹30	Asset A/c Dr. ₹30 To Bank A/c ₹30
Grant Received Entry	Bank A/c Dr. ₹10 To Def Govt. Grant (Def Inc) A/c ₹10	Bank A/c Dr. ₹10 To Asset A/c ₹10
Depreciation (5 Years SLM)	Depreciation A/c Dr. ₹6 To Acc. Depreciation A/c ₹6	Depreciation A/c Dr. ₹4 To Acc. Depreciation A/c ₹4
Grant Recognition in P&L (Year 1)	Def Govt. Grant (Def Inc) A/c Dr. ₹2 To P&L A/c ₹2	*No entry – Already adjusted against asset value*
Net Impact on P&L (Year 1)	**Depreciation ₹6 Lakhs** **Less: Grant Income ₹2 Lakhs** ➡ **Net Debit ₹4 Lakhs**	**Depreciation ₹4 Lakhs** ➡ **Net Debit ₹4 Lakhs**

- **Both approaches result in same net impact on P&L**: ₹4 Lakhs
- **Deferred Income Approach** keeps asset at full cost and shows grant separately.
- **Reduced Cost Approach** reduces the carrying amount of the asset directly.
- If entity follows SLM method, transfer of government grant to P&L can be done using SLM basis.

3.2.2.Non-Depreciable Fixed Assets

Option 1 : Reduce form the cost of Asset and show the Asset as a net amount.(Similar to non-depreciable asset)

Option 2 : Transfer to Capital Reserve or treat as deferred income as explained below

Case 1: When the conditions are already met – transfer to capital reserve.

Grants related to non-depreciable assets are <u>credited to capital reserve</u>, as there is usually no charge of depreciation in respect of such assets.

Entries required:

1. Asset Account....................... Dr.
   To Cash/Bank A/c.
(Being land acquired.)

2. Bank Account .... Dr.
   To Government Grant A/c
(Being the Grant received.)

3. Government Grant A/c .... Dr.
   To Capital reserve A/c
(Being a Government Grant credited to the Capital Reserve.)

Case 2: When the conditions are to be met in the future

If a grant related to a non-depreciable asset requires the fulfilment of certain obligations, the grant will be **transferred to Profit & Loss A/c in the ratio of costs** to be incurred to meet the grant conditions.

Entries required:

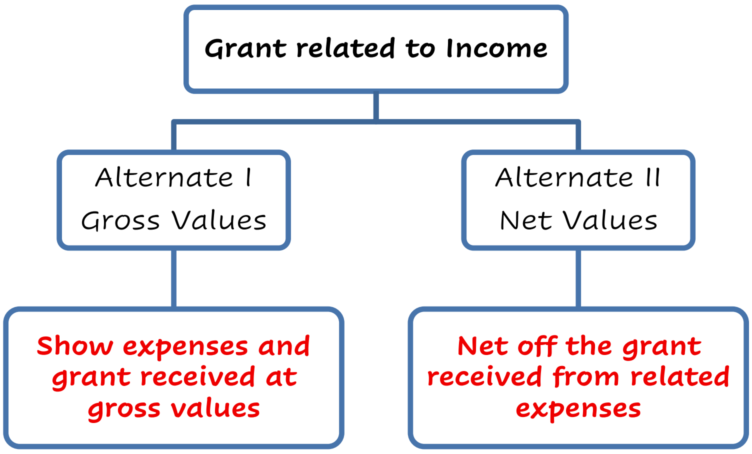
1. Asset Account....................... Dr.
   To Cash/Bank A/c.
(Being land acquired.)

2. Bank Account .... Dr.
   To Deferred Government Grant A/c
(Being the Grant received.)

3. Deferred Government Grant A/c .... Dr.
   To Profit & Loss A/c
(Being a Government Grant transferred to Profit and Loss A/c.)

3.3 Grants related to Revenue/Income

Grants may be provided by the Government for incurring a specific expenditure, like expenditure on public welfare, special expenditure on welfare of employees, expenditure on training of employees etc.



Example:
Kiran Ltd. received a grant of Rs. 25 Lakhs from the Local Authority for providing medical facilities to its employees.Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'.
Alternatively, Rs. 25 lakhs may be deducted in reporting the related expense i.e., employee benefit expenses.

3.4 Grants of the Nature of Promoter's Contribution:

Government grants are of the nature of promoters' contribution when they are:

- given with reference to the **total investment in an undertaking**, or
- by way of contribution towards its **total capital outlay** (for example, central investment subsidy scheme).

No repayment is ordinarily expected in respect of such grants. It may be given before or after the investment.

Accounting Treatment:

The grants are **treated as capital reserve** which can be:

- neither distributed as dividend
- nor considered as deferred income.

Journal Entries required:

1. Cash/Bank Account.......................... Dr.
To Government Grant A/c
(Being a grant received.)

---

2. Government Grant A/c .... Dr.
To Capital Reserve A/c
(Being Govt. Grant transferred to the Capital Reserve.)

Example:
Suraj Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment, for which no repayment was ordinarily expected. Moreover, there was no condition that the company should purchase any specified assets for this subsidy.
Having fulfilled all the conditions under the scheme, the company on its investment of Rs. 50 crores in capital assets, received Rs. 10 crores from the Government in January, 20X2 (accounting period being 20X1-20X2). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 20X2.
In the given case, the subsidy received is neither in relation to specific fixed assets nor in relation to revenue. Thus, it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by the government without related costs. The correct treatment is to credit the subsidy to capital reserve.

4 Refund of Government Grants

Government grants sometimes become refundable because certain conditions are not fulfilled.
Treatment: Treated as an extraordinary item (AS 5). The accounting entry will depend on the entry passed at the time of receipt.

4.1 Grant related to specific fixed asset:

4.1.1 Depreciable Fixed Asset

Method 1: Reduced Cost Approach

The amount refundable is recorded by **increasing the book_value of the asset**. i.e Debit the Fixed Asset Account.

Further, depreciation on the revised book value is provided prospectively over the residual useful life of the asset.

Method 2: Deferred Income Approach

The amount refundable is **debited to Deferred Govt. Grant Account** to the extent of available balance. If the balance is not sufficient, the amount is debited to Profit & Loss.

Srikanth Ltd. received a **specific government grant of ₹30 lakh** in **20X0–X1** for purchasing plant costing **₹150 lakh**.
The plant has a **useful life of 10 years**, and the grant was credited to **Deferred Income** in the Balance Sheet.

In **20X3–X4**, the company failed to comply with the grant conditions and therefore had to **refund the entire ₹30 lakh** to the Government.

At the date of refund:

- **Deferred Income balance** = ₹21 lakh
- **WDV of Plant** = ₹105 lakh

Journal Entry for Refund of Grant

Deferred Grant A/c	Dr.	21,00,000	
Profit & Loss A/c (Balancing figure) ...	Dr.	9,00,000	
To Bank A/c			30,00,000

(Being refund of grant; shortfall adjusted to P&L.)

! Important Note

The **carrying amount of the plant remains unchanged** because the grant was accounted for using the **Deferred Income approach**. Depreciation continues on the same basis as earlier.

4.1.2 Non-Depreciable Fixed Asset

Treatment at the time of Grant	Refund
Credited to Capital Reserve	Debit to Capital Reserve
Reduced from Cost of Asset	Debit to Cost of Asset

4.2 Grant related to Revenue:

When a revenue-related government grant becomes refundable, the refund is adjusted in the following order:

1. **First**, debit to Deferred Income Balance
2. **If the refund amount exceeds the deferred income balance**, or if **no deferred credit remains**, the excess is **charged immediately to the Profit and Loss Account**.

Example

ABC Ltd. received a government grant of **₹100 lakh** in the previous year for providing medical facilities to its employees.

- **₹70 lakh** has already been recognised in the Profit & Loss A/c.
- **₹30 lakh** remains as **unamortised deferred credit**.

Due to violation of certain conditions, **₹50 lakh** of the grant has become refundable.

Journal Entry for Refund

Deferred Grant A/c .... Dr.	30,00,000	
Profit and Loss A/c .... Dr.	20,00,000	
To Bank A/c		50,00,000

(Being grant refunded; excess charged to P&L.)

4.3 Grants of the Nature of Promoter's Contribution:

The relevant amount recoverable (in part or in full) by the government is **reduced from the capital reserve.**

5. Disclosure Requirements

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

6 Summary

Accounting Approaches:

Approach	Treatment	Used For
Capital Approach	Grant is treated as part of **shareholders' funds**.	Grants that have the characteristics similar to **promoters' contribution**.
Income Approach	Grant is recognised as **income** over one or more periods.	Applied in the case of **other types of grants**.

Type of Grant	**Non Monetary**	**Revenue**	**Grants for specific asset**		**Promoter's Contribution**
			Method 1	Method 2	
Accounting on Receipt of Grant	At concessional rates: At acquisition cost. Free: At nominal value	Shown as deferred credit balance	Deducted from cost of fixed assets	Shown as deferred income and charged in the ratio of depreciation	Amount credited to Capital Reserve A/c

Accounting on Refund of Grant	Amount of acquisition is increased in the books of accounts.	Deducted from deferred credit balance. Any balance after deduction is charged to P&L A/c as expense	Amount deducted initially is increased in the books of accounts.	Deferred income balance is decreased in the books of accounts.	Amount deducted from Capital Reserve A/c

AS 16
Borrowing Costs

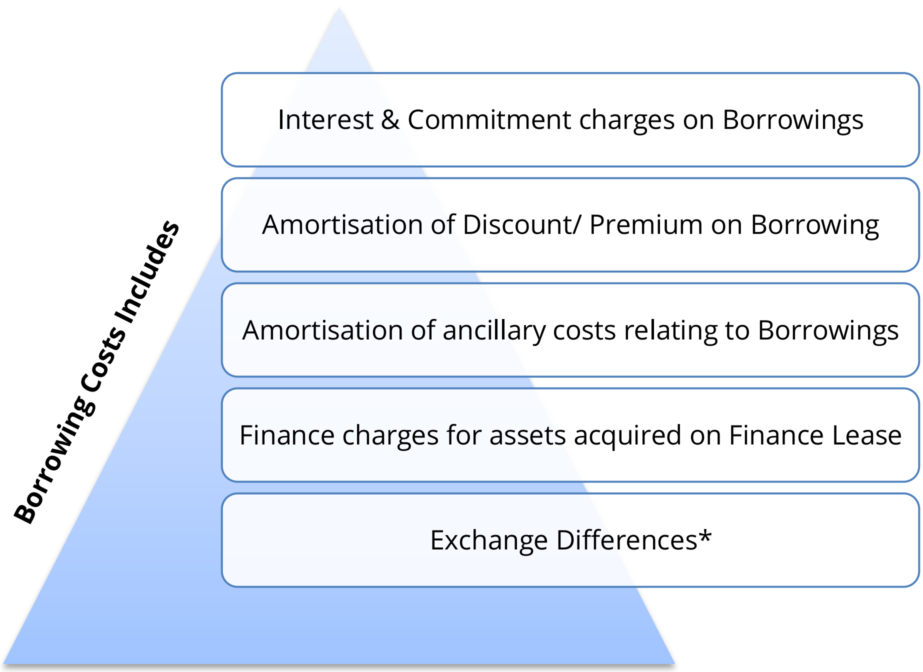
1. Scope of AS 16

The objective of AS 16 is accounting for borrowing costs. It does not deal with the cost of raising equity and preference share capital. It applies only to external borrowings.

2. Important Terms

Borrowing Costs

- Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.



*To the extent they are regarded as an adjustment to interest

Qualifying Assets

A qualifying asset is an asset that necessarily takes a <u>substantial period of time</u> to get ready for its intended use or sale.
Examples are

- Manufacturing plants
- Power generation facilities
- Inventories that require a substantial period of time to bring them to a saleable condition
- Investment properties

Exclusions of Qualifying Asset

- All other investments and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets.
- Assets that are ready for their intended use or sale when acquired also are not qualifying assets

Substantial period of time

Substantial period of time primarily depends on the facts and circumstances of each case. Ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case

Exchange differences on foreign currency borrowings- Para 46(e)

- Interest rate for the local currency borrowings is considered as that rate at which the enterprise would have raised borrowings locally if the enterprise had not decided to raise the foreign currency borrowings.
- Exchange difference to the extent of following is treated as borrowing cost :
  Interest on Local Currency Borrowings – Interest on Foreign Currency Borrowing
- Exchange gain is credited to P&L as per AS-11
- Exchange loss not considered as borrowing cost is treated as per AS-11

Example

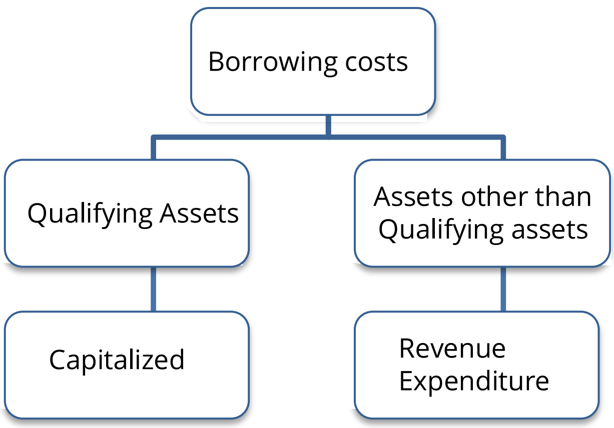
Suraj Ltd. has taken a loan of **USD 10,000** on **1 April 20X1** for a **specific qualifying asset**, at an interest rate of **5% p.a.**, payable annually.

- Exchange rate on 1 April 20X1: **₹45 per USD**
- Exchange rate on 31 March 20X2: **₹48 per USD**
- Equivalent borrowing rate in India: **11% p.a.**

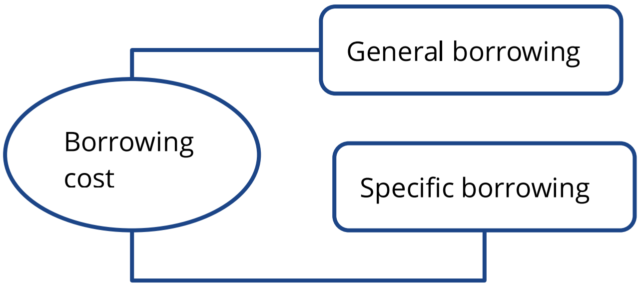
Particulars	Calculation	Amount (₹)
Interest on foreign currency loan	USD 10,000 × 5% × ₹48	24,000
Exchange difference on principal (A)	USD 10,000 × (48 – 45)	30,000
Interest on equivalent INR borrowing	USD 10,000 × ₹45 × 11%	49,500
Interest Savings (B)	49,500 – 24,000	**25,500**
Exchange difference eligible (lower of A & B)	Lower of ₹30,000 and ₹25,500	**25,500**
Total borrowing cost eligible for capitalisation **Hint : Total borrowing cost <= INR Cost**	24,000 + 25,500	**49,500**
Exchange difference to be accounted as per AS 11	30,000 – 25,500	**4,500**

3. Borrowing costs eligible for capitalisation

Treatment of Borrowing costs



Types of Borrowing



Specific Borrowings –

- Borrowed funds specifically for the purpose of obtaining a particular qualifying asset
- Borrowing costs that directly relate to that qualifying asset can be readily identified.
- If funds temporarily invested –
  Capitalised borrowing costs = Borrowing costs less any income earned on the temporary investment of those borrowings

General Borrowings –

- No Direct relationship between particular borrowings and a qualifying asset
- Amount of borrowing costs eligible for capitalisation determined by applying a capitalisation rate to the expenditure on that asset.
  The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.
- The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.

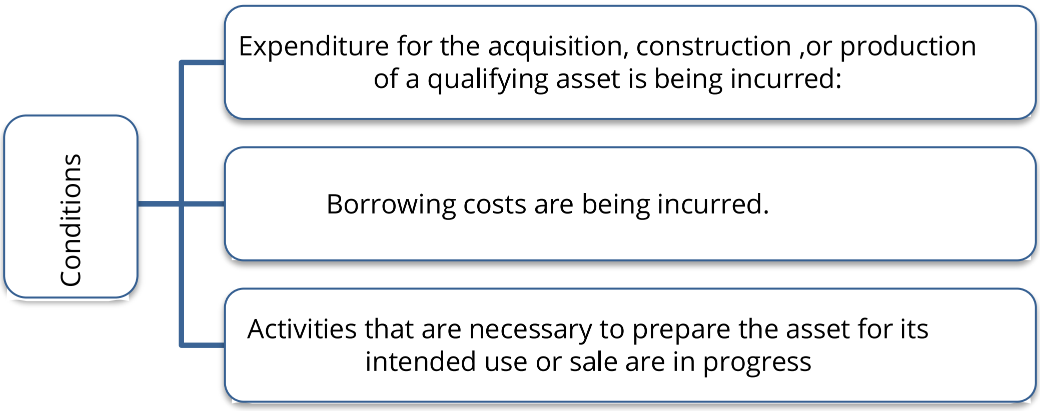
	Particulars	Formula / Basis
1	Capitalisation rate	Borrowing cost ÷ Weighted average borrowings
2	Amount eligible	Qualifying asset expenditure × Capitalisation rate
3	Maximum limit	Total borrowing costs incurred during the period
	Borrowing cost capitalised	**Lower of eligible amount and actual borrowing cost**

Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount

- When the carrying amount or the expected ultimate cost of the qualifying asset
- Exceeds its recoverable amount or net realisable value,
- Carrying amount is written down or written off in accordance with the requirements of other Accounting Standards.
- In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other Accounting Standards.

Commencement of Capitalisation –

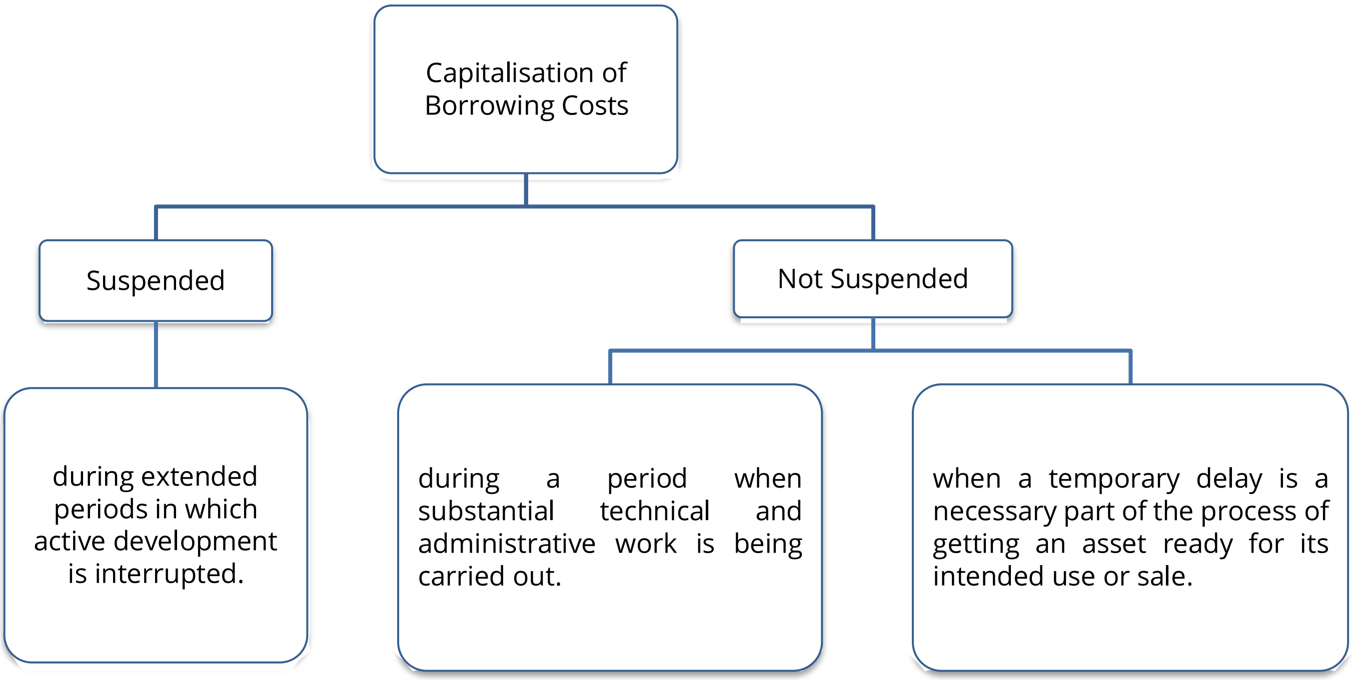
The capitalisation of borrowing costs as part of the cost of a qualifying asset should commence when all the following conditions are satisfied :



Suspension of Capitalisation

Capitalization of borrowing cost is commenced when the above mentioned 3 points are satisfied. However, if there is a temporary delay in which the active necessary developments are interrupted then there will be a suspension of capitalization. Suspension means stopping temporarily.

However, if the temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale, then there will be no suspension of capitalization.



Cessation of Capitalisation:

- Capitalisation of borrowing costs should cease/ stop when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
- An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.
- When the 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, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

Disclosure

The financial statements should disclose:

- The accounting policy adopted for borrowing costs ; and
- The amount of borrowing costs capitalised during the period.

Summary

- Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised. Other borrowing costs shall be expensed
- A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale
- Substantial period of time primarily depends on the facts and circumstances of each case
- Specific Borrowing – Actual borrowing cost less income on temporary investment
- General Borrowing – based on capitalisation rate
- **Commencement of Capitalisation** –
    - Expenditure is incurred
    - Borrowing costs are being incurred
- Activities are under progress **Suspension -** During extended periods when active development is interrupted.
- **Capitalisation of borrowing costs** - should cease/ stop when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
- **Disclosure**-Accounting policy adopted for borrowing costs ;and
  Amount of borrowing costs capitalised should be disclosed

AS 26
Intangible Assets

1. Introduction

1.1. Objective

Prescribing the accounting treatment for intangible assets that are not covered by any other accounting standard.

1.2. Scope

AS 26 specifies measurement of the carrying amount of intangible assets and requires certain disclosures about intangible assets. It is applicable to all enterprises.

Applies to (indicative list)	Does not apply to
Expenditure on **advertising, training, start-up cost**	Intangible assets held by enterprise for **sale in the ordinary course of business** (**AS 2** and **AS 7**)
Research and development activities	**Deferred tax assets** (**AS 22**)
Rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts	**Lease** that fall within the scope of **AS 19**
Patent, copyrights, and trademarks	**Goodwill** arising on **Amalgamation (AS 14)** and on **Consolidation (AS 21)**
Other intangible assets used such as **computer software** and other expenditure such as **start-up costs in extractive industries or by insurance enterprises**	**Financial Assets, Mining Assets, Insurance Policies, Discount on borrowing** & **Share issue expenses,** Expenditure in respect of **termination benefits**

1.3. Definitions:

Monetary Assets are money held or and assets to be received in **fixed or determinable** amounts of money. For Example: Cash, Trade receivables etc.

Non-Monetary Assets are assets **other than** monetary assets. For Example: Plant & machinery, market investments etc.

Amortisation is the systematic allocation of the depreciable amount of an **intangible asset** over its useful life

A financial asset **is any asset that is:**

- Cash
- A contractual right to receive cash or another financial asset from another enterprise
- A contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable
- An ownership interest in another enterprise

Fair value of an asset is the amount for which that asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

An active market is a market where all the following conditions exist:

- The items traded within the market are homogeneous.
- Willing buyers and sellers can normally be found at any time and
- Prices are available to the public.

An intangible asset is

- Identifiable
- Non-monetary asset
- Without physical substance
- Held for use in the production or supply of goods or services, for rental to others, or for administrative purposes

1. **Identifiable**- The asset can be **separated** from goodwill and can either be sold, transferred, licensed, rented, or exchanged independently.
   - Example: **Patent** – You can sell it to another company without selling the whole business.
2. **Non-monetary asset**v- It does not represent a **fixed or determinable amount of money**.
3. **Without physical substance**- Unlike PPE, it has **no physical form** you can touch, but it still has value.
   - Example: **Software license** – You can't physically hold it, but it gives you usage rights.
4. **Held for use in business (future economic benefit)**- It is used in production, supply, rental, or administration, and should help in **earning future income**.
   - Example: **Copyright of study material** – Can generate revenue when sold or licensed.

Some intangible assets may be contained in or on a physical substance such as compact disk (in case of computer software). The cost of these physical substance is **not significant**.

Accordingly, even though physical substance containing intangible asset is tangible in nature, it is treated **as part of the** intangible asset contained in it.

Marketing related

- Trade Mark
- Newspaper mastheads
- Internet Domain Names
- Non-competition agreements

Customer related

- Customer Lists
- Customer Contracts
- Customer Relationship
- Non-contractual customer relationship

Technology related

- Trade secrets
- Patents
- Databases
- Computer Software

Contract Based

- Franchise Agreements
- Employment Contracts
- License
- Lease Agreements

Artistic related

- Musical Works
- Magazines, Newspapers
- Plays, operas and ballets
- Pictures & photographs

Key Points to remember

- **Identifiable**:
  - Must be distinguished from **goodwill** i.e can be separated from goodwill and be sold, rented, exchanged independently
  - An asset is separable if it can generate **future economic benefits** independently.
  - **Separability** is not essential; it is enough if the asset, even when combined with other assets, can generate benefits. (Some intangible assets may generate FEB in combination with other assets – for e.g a software)
- **Control**:
  - Enterprise must have **power** to derive benefits and restrict others' access.
  - Usually arises from **legal rights**, but legal enforceability is not mandatory.
  - Control can also exist through other means of securing **future benefits**. (for e.g. keeping the codes or formula secret)
  - Training costs incurred on employees is not recognized as IA since the entity cannot control the employees.
- **Future Economic Benefits**:
  - Includes **revenue** from products/services, **cost savings**, or other advantages from asset use.
  - Asset should contribute to **cash flows** of the entity directly or indirectly.

Intangible Asset

- **Identifiable**: Clearly distinguished from goodwill.
- **Control**: Power to obtain future economic benefits and restrict the access to others.
- **Future economic benefits**: Ability to generate cash flows to the enterprise.

2. Recognition and Initial Measurement

Item recognised as IA if it

a. **meets the definition** of an intangible asset and
b. is probable that the **future economic benefits** that are attributable to that asset **will flow** to the enterprise and
c. **cost** of the asset can be **measured reliably**.

An intangible asset should be measured initially at **Cost.**

3. Measurement of Intangible Asset

Case	Measurement
Intangible Asset acquired on cash or credit (Purchased)	**Components of Cost** **Purchase Price** **(+) Import Duty & Non refundable taxes** **(+) Directly Attributable Expenditure** **(-) Trade Discounts & Rebates**
acquired in exchange of shares or other securities	• Fair market value(FMV) of asset acquired or • FMV of securities issued,

	Whichever is **more clearly evident.**
IA acquired in exchange for assets	Apply principles of AS 10 • **Fair Value (FV) of Asset given up** – (1st priority) • **Fair Value (FV) of Intangible Asset (IA) received** – (2nd priority) • If **no FV** or **no commercial substance** → use **Carrying amount of Asset given** • Use **more evident fair value**
IA acquired by way of Government Grant	• **Nominal value**, if given free of cost or • **Acquisition Cost**, if given at concessional rate.
IA acquired as part of Amalgamation	- A **transferee will recognise** an intangible asset if it meets the recognition criteria **even if** transferor has not recognised the intangible asset in its books and - If fair value of asset acquired as a part of amalgamation in the nature of purchase **cannot be measured reliably**, that asset is **not recognised** as separate intangible asset but is **included in goodwill**.

4. Internally Generated Intangible assets

Category	Treatment
Internally generated goodwill	Internally generated goodwill is **not recognised** as an asset because it is **not an identifiable resource** controlled by the enterprise that can be measured **reliably at cost**.
Internally generated Other Intangible Assets	**Research Phase (Always expensed):** Research is investigation undertaken with the aim of gaining new scientific and technical knowledge. **Development Phase (Check 6 conditions)* :** Development is an application of research findings to plan for the production of new or improved products, materials etc.
Internally generated brands, mastheads, publishing titles and items similar in substance	**Expenditure on developing these cannot be distinguished** from cost of developing the business as a whole. **Expensed**

*Intangible asset arising from development phase should be capitalised if, and only if, **all the conditions** set out in **Para 44** are met.

Para 44 Conditions: Entity must demonstrate

*a) the technical **feasibility** of completing the intangible asset so that it will be available for use or sale.*
*b) its **intention to complete** the intangible asset and use or sell it*
*c) its **ability to use or sell** the intangible asset*
*d) how the intangible asset will **generate probable future economic benefits**. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.*
*e) the availability **of adequate technical, financial, and other resources** to complete the development and to use or sell the intangible asset; and*
*f) its ability **to measure the expenditure** attributable to the intangible asset during its development reliably.*

If **research phase not separable from development phase**, then the expenditure incurred should be treated as if it is incurred during research phase only and hence should be **expensed out in statement of P&L**.

Cost of an Internally Generated Intangible Asset:

Cost	Explanation
Cost of Internally Generated Intangible Asset	Sum of expenditure incurred **from the time recognition criteria are first met**.
Directly Attributable Expenditure	All costs directly attributable to **creating or producing** the asset for its intended use after recognition.
Includes:	
a. **Material & Services**	Expenditure on material and services used or consumed.
b. **Salaries & Wages**	Salaries and wages of personnel directly engaged in generating the asset.
c. **Other Direct Expenditure**	Costs directly attributable to generating the asset. **Example:** Fees to register a legal right, amortisation of patents.
d. **Overheads**	Overheads that can be **allocated on a reasonable basis**.

Following are **not included** in cost of internally generated intangible asset:

- Selling, administrative and general overheads which **cannot be directly attributed** to making the asset for its intended use.
- Initial operating losses incurred before an asset achieves planned performance.
- Expenditure on training the staff to operate the asset.

5. Recognition of an Expense

Expenditure on intangible asset should be **recognised as an expense** when it is incurred **unless**:

a. It forms the part of cost of the asset that meets the recognition criteria.

b. The item is acquired in an amalgamation in the nature of purchase and cannot be recognised as an intangible asset – in which case the amount is a part of goodwill computation (AS 14)

Examples of expenditure that is recognised as an expense when it is incurred:

a) Expenditure on start-up costs **unless it forms part of cost of Fixed asset** under **AS 10**. Start-up costs include preliminary expenses, pre-opening costs , pre operating costs etc.
b) Expenditure on training activities,
c) Advertising and promotional activities,
d) Expenditure on relocating or reorganising part of an enterprise.

> Expenditure recognised as an expense cannot be reclassified as cost of intangible asset even in later years.

Subsequent Expenditure:

Subsequent expenditure on an intangible item which might give Future Economic Benefit **should be added to the cost of asset** if:

- It is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance and
- Expenditure can be **measured and attributed** to the cost reliably.

If conditions are not met -> Expense / Charge to P&L

Measurement subsequent to initial recognition:

After initial recognition, an intangible asset should be **carried at its cost less** any accumulated amortisation and any impairment losses.

6. Amortisation period and Method

- The depreciable amount of an intangible asset should be **allocated on a systematic basis** over the best estimate of its useful life. Amortisation should **commence** when the asset is **available for its intended use**.

- There is **rebuttable presumption** that the useful life of an intangible asset will **not exceed ten years** from the date it is available for use.

However, if an enterprise have persuasive evidence that the useful life of an asset will be longer than ten years than the enterprise should

a) Amortise the asset **over the best estimate** of its useful life.
b) Estimate the recoverable amount of an intangible asset **annually** to **identify any impairment losses**.
c) **Disclose the reasons** why the estimated useful life of such asset will **exceed ten years** and **factors** which played a significant role in determining it.

Amortisation method

There are many ways in which amortisation can be systematically allocated over the useful life of an asset such as

- Straight line method
- Diminishing balance method or WDV
- Production units method

The method used for an asset is selected based on expected **pattern of consumption of economic benefits** and should be **consistently applied** from period to period unless there is change in the expected pattern of consumption.

The **amortisation** period and method should be **reviewed** at **every year end**. If there's any significant changes in the method or pattern of consumption, changes should be accounted in **accordance with AS 5** to reflect the change.

7. Residual Value

Residual value is the **estimated value** of an intangible asset **at the end** of its useful life.
The residual value of an intangible asset is **assumed to be Nil** unless:

a) There is commitment by the third party to purchase the asset at the end of its useful life or
b) There is an active market for the asset and
   i. Residual value can be determined w.r.t market
   ii. It is probable that the market will exist at the end of useful life of an intangible asset.

8. Retirement and Disposal

An intangible asset should be **eliminated** from balance sheet if

- Disposed or
- When no future economic benefits are expected from its use.

The difference(gain/loss) between the net proceeds from disposal and carrying amount should be recognised as **income or expense** in the statement of P&L.

Intangible asset should be derecognised

Disposed

No future economic benefits are expected

Net disposal proceeds > Carrying amount: **Income recognised** in P&L.
Net Disposal Proceeds < Carrying amount: **Expense booked** in P&L.

9. Disclosures

The Financial Statements should disclose the following for each class of 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:
   i. additions, indicating separately those from internal development and through amalgamation.
   ii. retirements and disposals.
   iii. impairment losses recognised in the statement of profit and loss during the period (if any).
   iv. impairment losses reversed in the statement of profit and loss during the period (if any).
   v. amortisation recognised during the period; and

vi. other changes in the carrying amount during the period

Other Disclosures:

a) if an intangible asset is amortised over **more than ten years**, the **reasons** why it is presumed that the useful life of an intangible asset will exceed ten years from the date when the asset is available for use. In giving these reasons, the enterprise should describe the **factor(s)** that played a **significant role** in determining the useful life of the asset.
b) a description, the **carrying amount** and remaining **amortisation period** of any individual intangible asset that is material to the financial statements of the enterprise as a whole.
c) the existence and carrying amounts of intangible assets whose **title is restricted** and the carrying amounts of intangible **assets pledged** as security for liabilities; and
d) the **amount of commitments** for the acquisition of intangible assets

The financial statements should also disclose the **aggregate amount of research and development expenditure** recognised as an **expense** during the period.

10. Summary

Intangible asset – Identifiable, Non-monetary asset, Without physical substance , held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.(Future Economic Benefit)

Initial Recognition @ Cost

- Probable that future economic benefit will flow to the enterprise.
- Cost can be measured reliably.

Cost of Intangible asset

Separately acquired - Purchase price + Import duties + direct costs
Shares / Securities Exchanged – Fair value (of asset acquired or security issued)
Government Grant – Cost if given at concessional rate / Nominal Value if given free
Asset Exchanged – Fair Value
Asset acquired in amalgamation – Fair Value if recognition met

Internally Generated Intangible Asset

- Goodwill **should not** be recognised.
- **Research Phase**: Expensed out in P&L
  Development Phase: Capitalised, if **All** conditions met

Subsequent Expenditure, to be added to Cost if

- Generation of Future Economic benefits in excess of Originally planned.
- Expenditure can be measured and attributed to asset reliably.

Amortisation Period

- Presumed that useful life of asset will **not exceed ten years**.
- If > 10 years, then **reasons to be disclosed** for why presumption is rebutted.

Amortisation Method

- Method selected based on expected **consumption of economic benefits**.
- Should be **consistently applied** period after period.

Residual Value : Residual value is the estimated fair value of an intangible asset at the end of its useful life, assumed Nil.

Intangible asset should be derecognised

- Disposed
- No future economic benefits are expected

AS 19
Leases

1 Introduction

1.1 Objective

The objective of AS 19 is to prescribe

- appropriate accounting policies, and
- disclosures

in relation to finance leases and operating leases for lessees and lessors.

1.2 Scope

Exclusions from the AS:

a) Lease agreements to explore for or use natural resources, such as oil, gas, timber, metals, and other metal rights; and
b) licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents, and copyrights; and
c) lease agreements to use lands

Condition for Exclusions contracts for services that do not transfer the rights to use assets from one contracting party to the other.

1.3 Definitions:

1.3.1 *Lease*

A lease is **an agreement** whereby lessor (who gives asset on lease) conveys to the lessee (who takes asset on lease) in return for a payment or series of periodic payments (lease rents), the **right to use an asset** for an agreed period of time.

1.3.2 *Inception of lease*

The inception of the lease is **the earlier** of the **date of the lease agreement** and **the date of commitment by the parties** to the principal provisions of the lease.

1.3.3 *Lease term*

The lease term is the **non-cancellable period** for which the lessee has agreed to take **on lease the asset** together with any further periods for which the lessee has option to continue the lease of the asset, with or without any further payment.

1.3.4 *Minimum lease payments (MLP)*

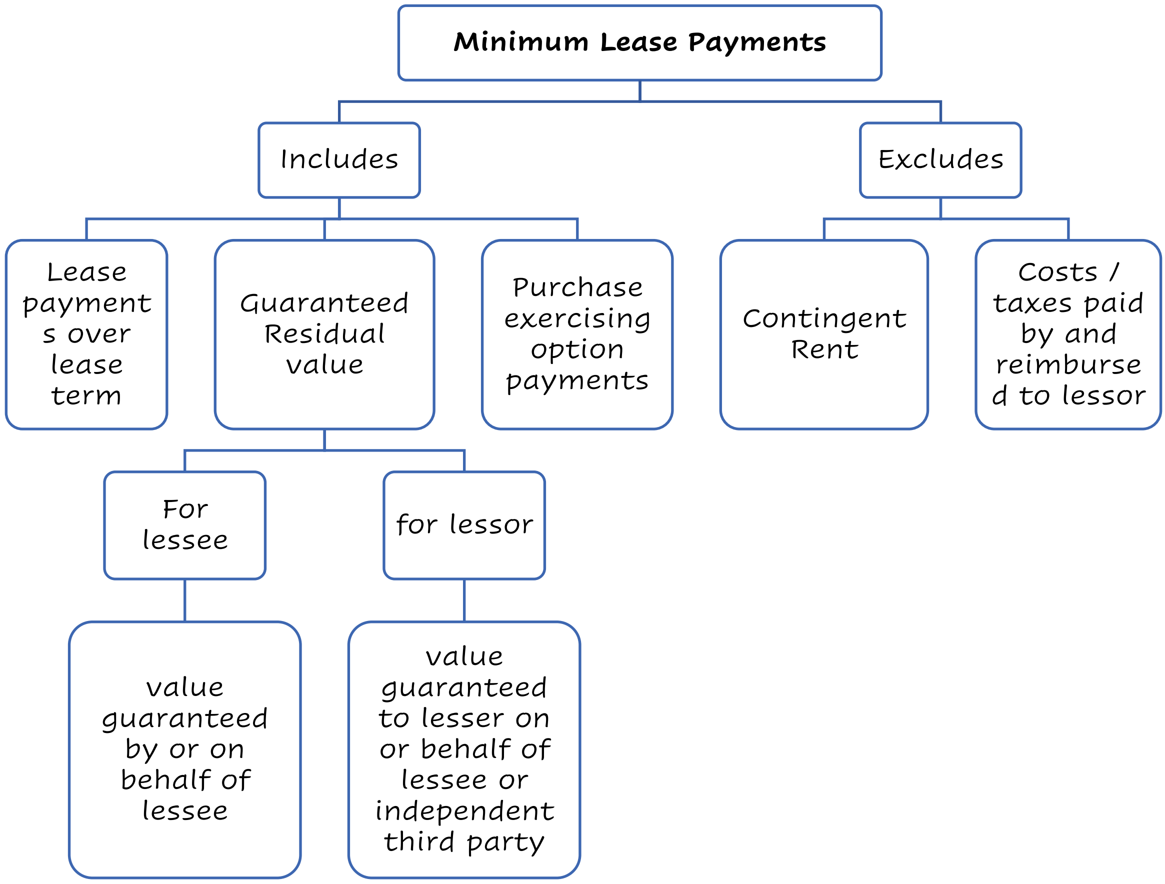
Minimum lease payments are the payments over the lease term that the lessee is, or can be required, to make excluding

- contingent rent,
- costs for services and taxes to be paid by and reimbursed to the lessor,

together with:

a) in the case of **the lessee**, any residual value guaranteed by or on behalf of the lessee; or
b) in the case of **the lessor**, any residual value guaranteed to the lessor:
   i. by or on behalf of the lessee; or
   ii. by an **independent third party** financially capable of meeting this guarantee.

Minimum lease payments comprise minimum payments payable over the lease term and the payment required to exercise the purchase option, in case the option to exercise is certain at inception.



1.3.5 *Economic Life / Useful Life*

a) the period over which an asset is expected to be **economically usable** by one or more users.

or

b) the **number of production** or similar **units expected** to be **obtained** from the asset by one or more users.

1.3.6 *Residual Value*

Residual value = **estimated fair value** of the asset at the end of the lease term.

1.3.7 *Guaranteed residual value:*

i. For **lessee**, that part of the residual value which is guaranteed (maximum amount that could become payable) by

- the lessee or
- a party on behalf of the lessee; and

ii. For **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.

1.3.8 *Unguaranteed residual value* of a leased asset is the amount by which the residual value of the asset **exceeds** its guaranteed residual value.

1.3.9 *Gross investment in the lease* is the aggregate of the **minimum lease payments** under a finance lease from the standpoint of the lessor and any **unguaranteed residual value** accruing to the lessor.

1.3.10 *Unearned finance income* is the **difference** between:

a. the **gross investment** in the lease; and
b. the present value of:
   i. the **minimum lease payments** under a finance lease from the standpoint of the **lessor**; and

ii. any **unguaranteed residual value** accruing to the **lessor**, at the interest rate implicit in the lease.

1.3.11 *Net investment in the lease* is the gross investment in the lease less unearned finance income.

Net Investment = PV of gross investment.

1.3.12 *The Interest rate implicit in the lease* the **discount rate** that, at the **inception of the lease**, causes the aggregate present value of:

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

Implicit rate is always calculated from the point of view of lessor.

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

2 Types of Leases

The classification of leases adopted in AS 19 is based on the extent to which risks and rewards incident to ownership of a leased asset lie with

- the lessor or
- the lessee.

Types of Leases
- Finance Lease
- Operating Lease

Finance lease: When a lease transfers substantially all the **risks and rewards** incidental to ownership of an asset. Transfer of title of an asset is not the relevant criterion.

Operating Lease: A lease is classified as an operating lease if it **does not** transfer substantially all the risk and reward incident to ownership i.e., Lease other than finance lease is operating lease.

Whether a lease is a finance lease or an operating lease **depends on the substance of the transaction rather than its Legal form.**

Indicators of finance lease:

Indicators of Finance Lease

- Transfer of ownership at the end of lease term
- Option to purchase leased asset at bargain
- Lease term covers major part of economic life
- PV of Min. Lease Payments is equal to fair value of asset at inception.
- Leased asset of specialized nature,cannot be used without major modifications.

If any of the above condition gets satisfied, then the lease would be classified as finance lease.

Additional indicators which would lead to lease being classified as finance lease are:

- Lessee cancels the lease and the lessor's losses associated with the cancellation are **borne by the lessee**.
- Gains or losses from the fluctuation in the fair value of the residual fall to the **lessee**; and
- Lessee can continue the lease for a secondary period at a rent which is substantially **lower than market rent**.

If the parties agree to change the provision of the lease in such a way which results in different classification of the lease, if the changed terms been in effect at the inception of the lease, then the revised agreement is considered as new agreement with revised terms.

Lease classification is made at the **inception of the lease.**

Changes in estimates (estimate of residual value or economic life) or changes in circumstances do not give rise to a new classification of a lease for accounting purpose.

3 Accounting for Finance Lease

3.1 In the books of lessor

- Recognise **asset under a finance lease in its balance sheet** as a receivable at an amount **equal to the net investment** in the lease.
- Gross Investment in lease (GIL) = Minimum Lease Payments (MLP) + Unguaranteed Residual value (URV)

MLP = Lease Rentals + Guaranteed Residual Value

Net Investment in Lease (NIL) = GIL- Unearned Finance Income.
Or Net Investment is simply the Present Value of Gross Investment.

Unearned Finance Income (UFI) = GIL- (PV Of MLP + PV Of UGR

Or UFI = GIL-NIL

Recognition of **finance income** should be based on a pattern reflecting a **constant periodic rate of return on the net investment** of the lessor **outstanding** in respect of the finance lease

- The Unearned finance income is recognised **over the lease term** on a systematic basis.
- **Recognise the transaction of sale in the statement of profit and loss** for the period as per sales policy. If low interest rates are quoted, profit on sale should be restricted to that which would apply if a commercial rate of interest were charged
- The initial direct costs such as commission or legal fees are recognised immediately in **the statement of P&L** or allocated **against the finance income** over the lease term.

The standard requires lessor **to review URV** used in computing the gross investment in lease **regularly.**

Disclosures to be made by lessor:

a) 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.
b) The **total gross investment** in the lease and the **PV of MLP** receivable at the balance sheet date, for each of the following periods:
    - Not later than one year **(≤ 1 yr)** .
    - Later than one year and not later than five years **(1yr to 5yrs**).
    - Later than five years. **(>5 yrs)**
c) **Unearned Finance Income**,
d) The **unguaranteed residual value** (URV) accruing to the benefit of the lessor.
e) The **accumulated provision for uncollectible MLPs**,
f) **Contingent rents** recognised in the statement of P&L for the period,
g) **General description** of the significant leasing arrangements of the lessor and
h) **Accounting policy** adopted in respect of **initial direct costs**.

3.2 In the books of lessee

- At the inception of the lease, lessee should record the asset at a value which is **lower of**:
    - **Fair value** of the leased asset at the inception of the lease.
    - **PV of MLP**

Discount rate is the interest rate implicit in the lease (from lessor point of view) or incremental borrowing rate if implicit rate is not known.

- Lease payments to be apportioned between **finance charge**(interest) and the reduction of **outstanding liability**(principal).
- Finance charges to be allocated to periods during the lease term to produce a constant rate of interest on the remaining balance of liability.
- A finance lease gives rise to depreciable expense for the asset as well as finance expense for each accounting period. The **depreciation policy** should be **consistent** for depreciable assets and depreciation should be **calculated based on AS 10**, Property, Plant & Equipment.
- If there is no reasonable certainty that lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the lease term or its useful life, whichever is shorter.
    - **Initial direct costs** which are directly attributable to activities performed by the lessee for finance lease are to be **included as part of amount** recognised as an asset.
    - The liability for a leased asset should be **presented separately in the balance sheet as a current liability or a long-term liability** as the case may be.
    - Enterprise should apply AS 28 Impairment of Assets on the leased asset to check impairment and determine recoverable amount.

Journal Entries in the books of Lessee will be:

1. Asset A/c ....Dr
   To Lessor A/c ....

(Being recognition of asset at lower of FV and PV of MLP from the standpoint of lessee)

2. Finance Charge A/c ....Dr
   To Lessor A/c ....

(Being Finance Charge due for the 1st year)

3. Lessor A/c .... Dr
   To Bank A/c ....

(Being payment of lease rent for the year)

4. P & L A/c ....Dr
   To Finance Charge ....

(Being recognition of Finance Charge as expense for the year)

Interest schedule

Year	*Opening Bal*	*Interest @ implicit rate*	*Lease payments*	*Closing Balance*
	A	B = A x Rate	C	D = A + B - C
Inception	Lower of FV or PV of MLP	Charged to P&L	Reduction from Lease liability	Liability shown in Balance sheet

Disclosures to be made by lessee:

a) Assets acquired under finance lease to be **segregated from the assets owned**.
b) **Net carrying amount** at balance sheet date for each class of assets.
c) a **reconciliation between the total MLPs** at the balance sheet date and their **present value**.
d) **Total MLP** at the balance sheet date, and their present value, for each of the following periods:
   - Not later than one year **(≤ 1 yr)** .
   - Later than one year and not later than five years **(1yr to 5yrs**).
   - Later than five years. **(>5 yrs)**
e) **Contingent rents** recognised as expense in the statement of P&L,
f) The **total of future minimum subsequent payments** expected to be received under the non-cancellable sub leases at the balance sheet date.
g) General description of the lessee's significant leasing arrangements including but not limited to the following:
   - The basis on which contingent rent payments are determined,
   - The existence and terms of renewal or purchase options and escalation clauses and
   - Restrictions imposed by the lease arrangements, such as those concerning dividends, additional debts, and further leasing.

4 Accounting for Operating Lease

4.1 In the books of lessor:

- Asset given under operating lease should be shown as fixed asset In its balance sheet.
- Lease Income should be recognised in the statement of P&L on a **straight line basis over the lease term**, unless another systematic basis is more representative of the period in which benefit is derived.
- Depreciation should be recognised as per the depreciation policy of the lessor for similar assets, and it should be calculated based on AS 10.

Journal Entries in the books of lessor will be :

1) Asset A/c ....Dr
   To Lessee A/c......
(Being asset given in operating lease brought into books)

---

2) Lessee A/c ....Dr
   To Lease Equalization A/c
   To Lease Rent
(Being lease rent due for the year)

> The difference between lease rent due and lease rent recognised can be credited to Lease equalization Account.
>
> Since lease rent due and lease rent recognised must be same, the lease equalization account will be closed in terminal year.

3) Bank A/c ....Dr
   To Lessee A/c
(Being receipt of lease rent for the year)

---

4) Lease Rent ....Dr
   To P&L A/c
(Being recognition of lease rent as income for the year)

---

5) Depreciation A/c ....Dr
   To Asset A/c
(Being depreciation for the year)

---

6) P&L A/c ....Dr
   To Depreciation A/c
(Being depreciation for the year transferred to P&L A/c)

Disclosures to be made by Lessor:

a) For **each class of assets**,
- the **gross carrying amount**,
- **the accumulated depreciation** and accumulated **impairment losses** at the balance sheet date; and
- **depreciation recognised** in the statement of P&L for the period,
- **Impairment losses recognised and reversed** in the statement of P&L for the period.

b) the **future MLP** under non-cancellable operating lease in the aggregate and for each of the following periods:
- Not later than one year (**≤ 1 yr**) .
- Later than one year and not later than five years (**1yr to 5yrs**).
- Later than five years. **(>5 yrs)**

c) **Total contingent rents** recognised as income in the statement of P&L for the period.
d) **General description** of the lessor's significant leasing arrangements,
e) **Accounting policy** adopted in respect of initial indirect costs.

4.2 In the books of lessee:

- Lease payments should be recognized in **the statement of P&L** on a **systematic basis** over the lease term.
- Lease payments may be made as to suit the payment capacity of the lessee.

Journal Entries:

1) Lease rent A/c ....Dr
Lease Equalization A/c......Dr
To lessor A/c
(Being lease rent due)

---

2) Lessor A/c.......Dr
To Bank A/c
(Being payment of lease rent for the year)

---

3) P&L A/c ....Dr
To Lease rent A/c
(Being recognition of lease rent as expense for the year)

Disclosures to be made by lessee:

a) The **total of future MLP** under non-cancellable operating lease for each of the following periods:
   - Not later than one year **(≤ 1 yr)** .
   - Later than one year and not later than five years **(1yr to 5yrs)**.
   - Later than five years. **(>5 yrs)**

b) The **total of future minimum sublease payments** expected to be received under non-cancellable subleases at balance sheet date.

c) **Lease payments recognised in the statement of P&L** for the period with separate amounts for MLP and contingent rents.

d) **Sub lease payments received and recognized** in the statement of P&L,

e) **General description** of the lessee's significant leasing arrangements including but not limited to, the following:
   - The basis on which contingent rent payments are determined.
   - The existence and terms of renewal or purchase options and escalation clauses; and
   - Restrictions imposed by lease arrangements such as those concerning dividends, additional debt, and further leasing.

The **depreciation of leased assets** should be as per **AS 10**, Property, Plant and Equipment.

5 Sale and leaseback

- Sale and leaseback is a **financial transaction** that allows a person to lease an asset to himself after selling it to another party.
- Under such transaction, an asset previously owned by seller(lessee) is sold to someone else(lessor) at an agreed valuation and is leased back to the seller. The lessee gets cash immediately and is required to make periodic payments in the form of lease rents for right to use property.
- For example: Mr A sells its plant & Machinery to Mr B and then enters into an agreement with Mr B to lease back the plant- & machinery for a term of 3 years.
- The accounting treatment of sale & leaseback depends upon the type of lease involved.

- When sale & leaseback results in **finance lease**, the excess or deficiency of sale proceeds over the carrying amount should be **deferred over the lease term** in proportion to the depreciation of the leased asset.

- When sale & leaseback results in **operating lease,** there can be three possible scenarios.

Scenario 1: Sale Price =Fair Value

Treatment : Profit or loss should be recognised immediately.

Scenario 2: Sale price< Fair Value

Treatment : Profit or loss should be recognised immediately. However, if the loss is compensated by the future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which asset is expected to be used.

Scenario 3: Sale price> fair value

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

Note: *Students are requested to refer Illustration 3 of the Module for the better understanding of the concept.*

6 Summary

- A lease is an **agreement** between lessor (owner) and lessee (user) where right to **use an asset** is given for **periodic payments** (lease rents) for an agreed period.
- **Two types of leases:** Finance lease and operating lease.
  A **finance lease** - substantial risk and rewards incidental to ownership gets transferred.
  An **operating lease** is a lease other than finance lease

Finance Lease Treatment

In the books of Lessor

- Recognise lease receivable at Net Investment in Lease(PV of GIL).
- Recognise Finance Income over lease term on systemnatic basis.
- Initial Indirect cost can be tfd to P&L or adjusted against Finance Income over lease term.
- In case of manufacture or dealer lessor,transaction of sale should be recognised in the statement of P&L.

In the books of Lessee

- Recognise leased asset and leased liability
- Recognised at PV of MLP or Fair Value,whichever is lower.
- Apportion lease rent as Finance Charge (P&L) and as principal (reduction in O/S liability.
- Charge depreciation on leased asset as per AS 10.
- Initial Indirect cost to be added in cost of asset.

Disclosures in case of Finance Lease

In the books of Lessee

- Asset acquired to be segregated
- Net carrying amount for each class of assets.
- Reconciliation between total of MLP and thier PV at B/S date.
- Contingent rent recognised as expense
- Total of future MLP expected to be received.
- General description of lessee's significant leasing arrangements.

In the books of lessors

- Reconciliation b/w total gross investment and PV of MLP at B/S date.
- Unearned finance income.
- Unguranteed residual value accruing to lessor.
- Accumulated provision for uncollectible MLP.
- Contingent rent recognised as expense.
- General description of lessor's significant leasing arrangements.
- Accounting policy adopted w.r.t initial indirect costs.

Operating Lease Treatment

In the books of Lessor

- Shown as Fixed Asset in B/S
- Charge Depreciation and Debit in P&L
- Lease rent to be recognised in SLM basis.

In the books of Lessee

- Lease payment to be expensed in statement of P&L
- On Straight Line Basis

Operating Lease - Disclosures

In the books of lessee

- Total of future MLP under various periods.
- Total of future MLP expected to be received.
- Lease payments recognised in P&L.
- Sublease payments received recognised in the statement of P&L.
- General description of lessee's significant leasing arrangements.

In the books of Lessors

- Gross carrying amounts, acc. depreciation and acc. Impairment losses
- Future MLP under various periods.
- Total Contingent rents recognised in P&L.
- General description of lessor's significant leasing arrangements.
- Accounting policy adopted w.r.t Initial Indirect Costs

Sale and leaseback: Financial transaction involving the sale of an asset by the vendor and the leasing of the same asset back to the vendor.

The seller or lessee receives cash immediately and makes periodic payments in the form of lease rents for right to use the asset.

The accounting treatment of a sale and leaseback depends upon the type of lease involved.

AS – 29
Provisions, Contingent Liabilities and Continent Assets

1 Scope

1.1 Objective

- Appropriate recognition criteria and measurement for provisions and contingent liabilities
- Sufficient information disclosed to enable users to understand their nature, timing and amount.
- Appropriate accounting for contingent assets

1.2 Scope

- financial instruments (including guarantees) that are not carried at fair value.
- Onerous executory contracts
- provisions, contingent liabilities and contingent assets of insurance enterprises other than those arising from contracts with policy-holders.
- provisions for restructuring (including discontinuing operations).

Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations

1.3 Exclusions from Scope

Provisions and contingent liabilities and contingent assets

- resulting from
  - financial instruments that are carried at fair value;
  - executory contracts, except where the contract is onerous;
- arising in insurance enterprises from contracts with policy- holders;
- covered by another Accounting Standard (AS 7, AS 15, AS 19, AS 22)
- related to depreciation, impairment of assets and doubtful debts

Onerous contracts

Contracts where, Unavoidable costs of meeting the obligation (least net cost of exiting from the contract) > Economic benefits expected to be received

Present obligation for Onerous contract is recognised and measured as a provision as per this Standard.

2 Definitions

2.1 Provision

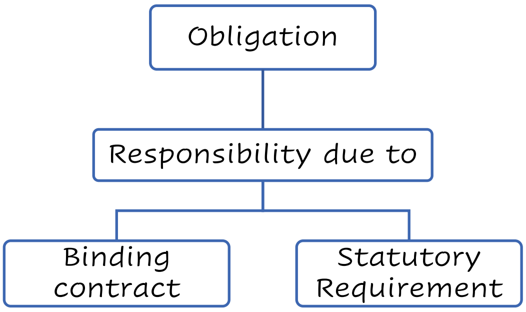
Liability which can be measured only by using a substantial degree of estimation.

2.2 Liability

Present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

2.3 Obligating event

Event that creates an obligation that results in an enterprise having no realistic alternative to settling that obligation.



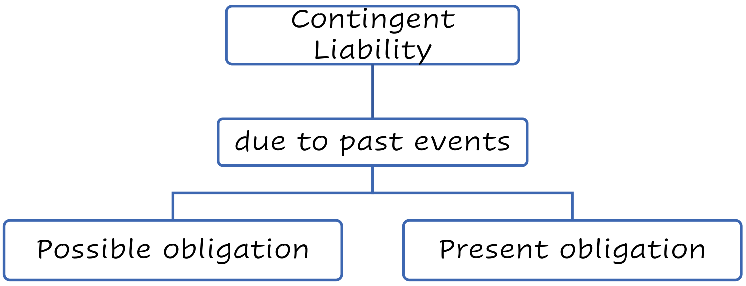
2.4 Contingent liability

(a) a **possible obligation** that arises from past events and the existence of which will be confirmed only by the occurrence or non- occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(b) a **present obligation** that arises from past events but is not recognised because:

- it is **not probable** that an outflow of resources embodying economic benefits will be required to settle the obligation; or
- a **reliable estimate** of the amount of the obligation cannot be made.

Note – If it is probable that there would be outflow of resources and an estimate can be made, the entity will recognise a provision.



2.5 Contingent asset

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.

2.6 Present obligation

An obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not (>50% probability)

2.7 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.

2.8 Restructuring

Programme that is planned and controlled by management, and materially changes either:

- the scope of a business undertaken by an enterprise; or
- the manner in which that business is conducted.

2.8.1 Examples of Restructuring

- sale or termination of a line of business;
- closure of business locations in a country or region or
- relocation of business activities from one country or region to another;
- changes in management structure
- fundamental re-organisations that have a material effect on the nature and focus of the enterprise's operations.

No obligation arises for the sale of an operation until the enterprise is committed to the sale, i.e., there is a binding sale agreement.

2.8.2 Direct expenditures

A restructuring provision should include only the direct expenditures arising from the restructuring which are those that are both:

(a) necessarily entailed by the restructuring; and

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

Identifiable future operating losses up to the date of a restructuring are **not included in a provision.**

3 Recognition of Provision

A provision should be recognised when:

(a) an enterprise has a **present obligation** as a result of a past event;

(b) it is **probable that an outflow of resources** embodying economic benefits will be required to settle the obligation; and

(c) a **reliable estimate can be made** of the amount of the obligation. If these conditions are not met, no provision should be recognised.

Provision should be recognised only if

- Present obligation exists
- Outflow of resources is probable
- Reliable estimate can be made

The provision is measured before tax; the tax consequences of the provision, and changes in it, are dealt with under AS 22, Accounting for Taxes on Income.

A provision should be used only for expenditures for which the provision was originally recognised.

3.1 Present Obligation

If it is not clear whether the past events give rise to present obligation, an enterprise determines whether a present obligation exists at the balance sheet date by taking account of all available evidence, including any additional evidence provided by events after the balance sheet date.

On the basis of such evidence:

(a) present obligation exists at the balance sheet date - provision is recognised (if the recognition criteria are met); and

(b) present obligation doesn't exist at the balance sheet date - disclose a contingent liability, if possibility of an outflow of resources is high

3.2 Past Events

Financial statements deal with the financial position of an enterprise at the end of its reporting period and not its possible position in the future.

Obligations arising from past events existing independently of an enterprise's future actions (i.e. the future conduct of its business) that are recognised as provisions. The only liabilities recognised in an enterprise's balance sheet are those that exist at the balance sheet date. It is not necessary, to know the identity of the party to whom the obligation is owed – indeed the obligation may be to the public at large.

3.3 Probable Outflow of Resources Embodying Economic Benefits

Outflow of resources or another event is regarded as probable if the event is more likely than not to occur.
Where there are a number of similar obligations (e.g. 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.

Probability that the event will occur > probability that it will not.

3.4 Reliable Estimate of the obligation

Where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability

4 Continent Liabilities

An enterprise should not recognise (record) Contingent Liability. It is only disclosed.

- 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.
- Contingent liabilities are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable, if it becomes probable, provision is recognised in that period.

5 Contingent Assets

An enterprise should not recognise Contingent Asset. It is not disclosed in the financial statements

Contingent assets arise from

- unplanned events or
- other unexpected events

that give rise to the possibility of an inflow of economic benefits to the enterprise.

Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

6 Measurement

6.1 Best Estimate

- Provision recognised should be the **best estimate of the expenditure required to settle the present obligation** at the balance sheet date.
- Provision amount should be discounted to its present value only in case of
  - decommissioning,
  - restoration and
  - similar liabilities

  that are recognised as cost of Property, Plant and Equipment.

Estimates are based on

- judgment of the management of the enterprise,
- experience of similar transactions and,
- reports from independent experts
- evidence from events after the balance sheet date.

The risks and uncertainties should be taken into account in reaching the best estimate of a provision.
Provisions should be **reviewed at each balance sheet date and adjusted to reflect the current best estimate**. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.

6.2 Discount rates

- The discount rate (or rates) should be a **pre-tax rate (or rates) that reflect(s) current market assessments** of the time value of money and the risks specific to the liability.
- The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted.
- Periodic unwinding of discount should be recognised in the statement of profit and loss.

6.3 Risk and Uncertainties

Risk describes variability of outcome.

Uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. Care is needed to **avoid duplicating adjustments** for risk and uncertainty with consequent overstatement of a provision.

6.4 Future Events

Future events that may affect the amount required to settle an obligation should be **reflected in the amount of a provision** where there is sufficient objective evidence that they will occur.

6.5 Expected Disposal of Assets

Gains from the expected disposal of assets should **not be taken into account** in measuring a provision.

6.6 Reimbursements

- Reimbursement of expenses by other parties should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation.
- The **reimbursement should be treated as a separate asset** and the provision is recognised for the full amount of the liability
- The amount recognised for the reimbursement should not exceed the amount of the provision.

In P&L, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.

7 Disclosures

7.1 Provisions

For each class of provision, an enterprise should disclose:

(a) the carrying amount at the beginning and end of the period;
(b) additional provisions made in the period, including increases to existing provisions;
(c) amounts used (i.e., incurred and charged against the provision) during the period; and
(d) unused amounts reversed during the period.
(e) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;
(f) an indication of the uncertainties about those outflows. major assumptions made concerning future events; and
(g) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Small and Medium-sized Company and a Micro, Small and Medium-sized Enterprise (Level IV, III and II non-company entities), may not comply

7.2 Contingent Liabilities

(a) a brief description of the nature of the contingent liability and,
(b) where practicable:
  i. an estimate of its financial effect
  ii. an indication of the uncertainties relating to any outflow; and
  iii. the possibility of any reimbursement.

Where any of the information is not disclosed because it is not practicable to do so, that fact should be stated.

Information prejudicial to the Enterprise

An enterprise need not disclose such information in a dispute with other parties on the subject matter of the provision or contingent liability, but should disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

8 Summary

AS 29 deals with appropriate recognition criteria and measurement for provisions and contingent liabilities

Provision should be recognised only if

- Present obligation exists
- Outflow of resources is probable
- Reliable estimate can be made

Contingent Liability — is due to past events

- Possible obligation
- Present obligation

An enterprise should not recognise

- Contingent Liability
- Contingent Asset. It is not disclosed in the financial statements

Provision recognised should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date and it should be reviewed at every balance sheet date subsequently

Provision amount should be discounted to its present value only in case of

- decommissioning,
- restoration and
- similar liabilities

that are recognised as cost of Property, Plant and Equipment.

Disclosures

Provisions

- Opening & closing to carrying amount
- Additions and reversals to provisions
- Amounts used during the period
- Nature of obligation
- Timing of Outflows of economic benefits
- Uncertainities & associated assumptions
- Expected reimbursement

Contingent Liability

- brief description of the nature, where practicable:
- an estimate of its financial effect
- an indication of the uncertainties relating to any outflow; and
- the possibility of any reimbursement.

AS 15
Employee Benefits

1 Objective

- to prescribe the ***accounting*** and ***disclosure*** for employee benefits.
- AS 15 requires an entity to recognise:
  - a liability for advance services received from an employee; and
  - an expense for consumption of economic benefits raised from the service provided by an employee in exchange for employee benefits.

2 Scope

- The employee benefits to which this Standard applies include those provided:
  - under ***formal plans or other formal agreements*** between an entity and individual employees, groups of employees or their representatives;
  - under ***legislative requirements***, or through industry arrangements; or
  - by those ***informal practices*** that give rise to a constructive obligation.

This Standard shall be applied by an employer in accounting for all employee benefits, **except those to which Share-based Payment**, applies

- This Standard does not deal with reporting by employee benefit plans (e.g by provident fund trusts)

3 Employee benefits

- ***Employee benefits*** means all forms of consideration given by an entity
  - in exchange for **service rendered** by employees or
  - for the **termination** of employment.
- The standard is applicable to benefits provided to all types of employees – full time/ part time
- Employee benefits can be paid in cash or kind

Employee benefits includes

- **Short Term Benefits** — Expected to be settled wholly before 12 months
- **Post Employee Benefits** — Payable after the completion of employment
- **Other Long Term Benefits** — Other than short-term, post-employment and termination benefits
- **Termination Benefits** — Provided in exchange for the termination of an employee's employment

Employee benefits Include benefits provided either to	**Employee benefits may be settled by payments made either-**	**An employee may provide services to an entity on a-**
employees; or	directly to the employees; or	full-time; or
their dependants; or	their spouses; or	part-time; or
their beneficiaries.	their children; or	permanent; or
	their other dependants; or	casual; or
	others, such as insurance companies	temporary basis.

4 Short term employee benefits

- Short-term employee benefits are employee benefits (other than termination benefits) which fall due wholly within twelve months after the end of period in which the employees render the related service.
- Short term employee benefits include
  - wages, salaries and social security contributions;
  - paid annual leave and paid sick leave;
  - profit-sharing and bonuses; and
  - non-monetary benefits

Recognition and Measurement

- Enterprise should recognise the undiscounted amount of short term employee benefits expected to be paid for employee's service during the accounting period
  - As a liability (after adjusting the payments made)
  - As a expense (unless the benefits can be included as a part of asset)

4.1 Short-term Compensated (paid) absences

An employer may compensate an employee for absence for various reasons including holidays, sickness and short-term disability, maternity or paternity

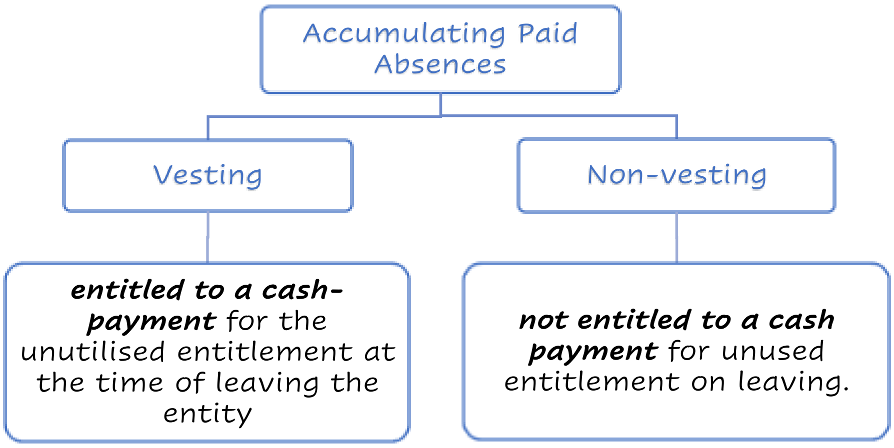
Entitlement to paid absences fall into two categories as follows:

4.1.1 Non-accumulating Compensated Absences

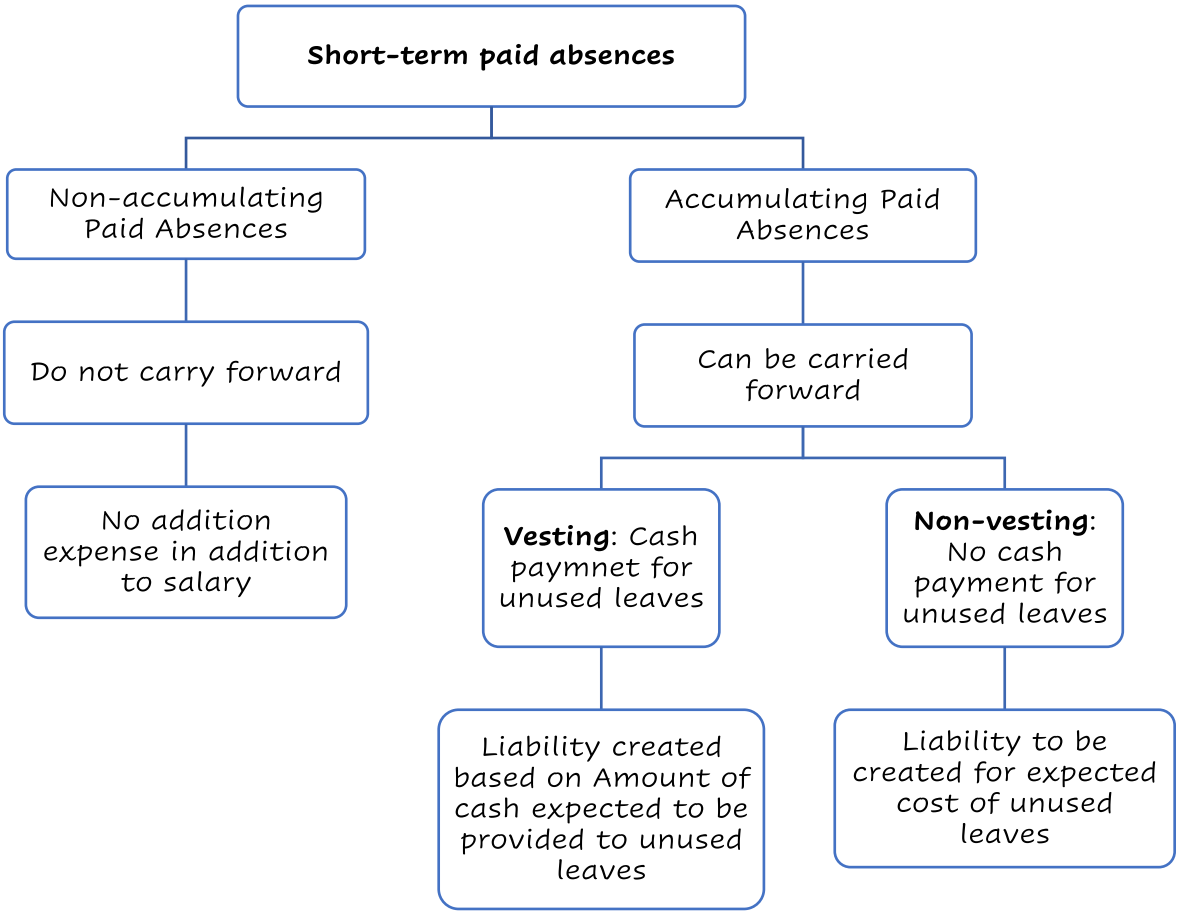
- These are the absences that ***do not carry forward*** and they will lapse if the current period's entitlement is not used in full by the employee.
- Cost of non-accumulating absences should be recognized as and when they arise.

4.1.2 Accumulating Compensated Absences

- These are the absences that are ***carried forward and can be used in future*** periods if the employee is not able to use them in current period.



- An entity shall measure the expected cost of accumulating compensated absences as the **additional amount that the entity expects to pay as a result of the unused entitlement** that has accumulated at the end of the reporting period



4.2 Profit Sharing and Bonus Plans

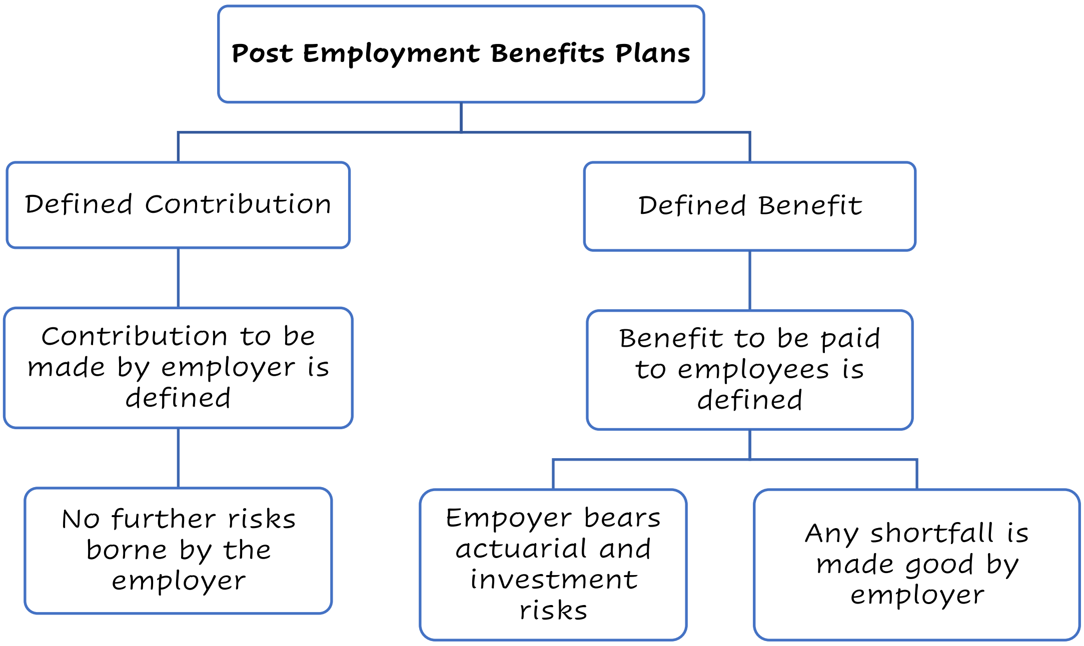
Profit sharing distributes a portion of company profits among employees, fostering a sense of collective success. Bonus plans reward individuals based on performance or achievements, motivating higher productivity. Both align financial incentives, promoting teamwork and goal attainment within the organization.

Conditions to recognise expenses

- present obligation to make such payments as a result of past events
- reliable estimate of the obligation can be made.

5 Post-employment benefits

- Post-employment benefits include:
  - Retirement benefits such as pensions and lump sum payments on retirement
  - Other post-employment benefit such as post-employment life insurance and post-employment medical care.



5.1 Defined contribution plans

- The entity's ***obligation*** (legal or constructive) is limited to the ***amount that it agrees*** to contribute to the fund**.**
- The amount of the post-employment benefits received by the employee is determined by the amount of contribution paid by an entity
- Under defined contribution plan
  - ***actuarial risk*** *(that benefits will cost more than expected)* and
  - ***investment risk*** *(assets invested will be insufficient to meet expected benefits)*
  - will fall on the ***employee***
- ***Discounting*** should be done if contribution is payable after ***12 months*** from reporting date
- Accounting for DCP is straightforward. An entity recognises the amount it contributes to the plan as an expense or asset.

5.2 Defined Benefit plans

- The entity's ***obligation*** is to provide the ***agreed benefits (****Benefits are defined)* to current and former employees;
- The ***actuarial risk*** and ***investment risk*** fall on the ***entity***
- If actuarial or investment experience are worse than expected, the entity's obligation may be increased.

Differences

Particulars	Defined Contribution Plans	Defined Benefit Plans
Entity's obligation	Limited to the amount that it agrees to contribute to the fund.	To provide the agreed benefits to current and former employees.
Determination of the amount of post-employment	determined by the amount of contribution paid by an entity and employee + return on it	Pre-determined / as agreed

benefit		
Risk bearer	Actuarial risk and investment risk fall on the employee	These risks fall on entity

Gratuity Scheme – Defined Benefit or Defined Contribution?

- Since benefits are defined – it's a defined benefit plan
- If employer makes contribution to a fund or insurance company for Gratuity Payment
  - Defined Contribution plan – if no liability retained
  - Defined benefit plan – If employer settles the liability directly or meets shortfall.

5.2.1 Actuarial Assumptions

- The benefit payable to beneficiaries depends on multiple factors (variables)
- Actuarial assumptions are an entity's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits
- Actuarial assumptions shall be ***unbiased*** and ***mutually compatible***.

Actuarial assumptions comprise of

Demographic Assumptions	• Average age of employees • Mortality- during and after employment • Rate of employee turnover, disability & early retirement • Proportion of plan member with dependants • Claim rates under medical plans etc.
Financial Assumptions	• Discount rate • Future salary & benefit levels • In case of medical benefits, future medical cost, including claim handling costs • Expected rate of return on plan assets etc.

5.2.2 Defined Benefit Obligation (DBO)

Defined Benefit Obligation

Obligation under a defined benefit plan

PV of Defined Benefit Obligation

PV of obligation resulting from employee service in current and prior periods

Particulars	*Amount (Rs.)*
Opening Balance- DBO	**XXXX**
(+) Current Service cost	XXXX
(+) Interest cost	XXXX
(+/-) Past Service Cost/(gain)	XXXX
(+) Actuarial Loss	XXXX
(-) Actuarial Gain	XXXX
(-) Benefit Payment	XXXX
(-) Gain on Settlement	XXXX
(+) Loss on Settlement	XXXX
Closing balance- DBO	**XXXX**

5.2.3 Plan Assets

Plan assets comprise assets held by long term employee benefit fund and qualifying insurance policies. These assets are used to meet the obligations of employee benefit plans.

5.2.4 Balance Sheet Presentation

Net amount of defined benefit liability on balance sheet is measured as

PV of DBO	Xxx
(-) FV of Plan Assets	Xxx
(-) Past Service Cost (Unamortised balance)	Xxx
Net Defined Benefit Liability	

5.2.5 Ceiling Limit on plan assets

In case the plan assets have a higher value than the PV of DBO, the entity should present net amount as an asset. The Asset should be recognised at lower of

(a) Plan asset – PV of DBO
(b) Present value of benefits available in form of refunds or future reduction.

[The idea is not to overstate the assets in books]

Actuarial gain/loss will be recognised immediately in the statement of ***profit and loss as income or expense.***

5.2.6 Actuarial gains and losses

- Actuarial gains and losses are changes in the present value of the defined benefit obligation resulting from:
  - experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and
  - the effects of changes in ***actuarial assumptions.***
- ***Actuarial gains or losses are recognised in the statement of PL immediately.***

5.2.7 Settlement

A settlement occurs when an employer enters into a transaction that eliminates all further legal or constructive obligations for part or whole of the benefits provided under a defined benefit plan.

5.2.8 Expense in Profit & Loss

The following amounts are recognised in the statement of P&L

Particulars	***Amount (Rs.)***
Current Service cost	XXXX
(+) Interest cost	XXXX
(-) Expected return on plan assets	
(+/-) Past Service Cost/(gain) [recognised]	XXXX
(-) Actuarial Loss	XXXX
(+) Actuarial Gain	XXXX
(-) Gain on Settlement	XXXX
(+) Loss on Settlement	XXXX
(+) Loss due to asset ceiling	XXXX

6 Other Long Term Employee Benefits

Settlement	>12 months from the end of financial reporting period
Benefits	Other than ➢ Short-term employee benefits

	➢ Post-Employee benefits ➢ Termination benefits
Example	➢ Long-term paid absences ➢ Jubilee/Long term service benefits ➢ Long-term disability benefits ➢ profit-sharing and bonus plan ➢ deferred remuneration.

7 Termination benefits

Termination benefits result from either:

- an entity's decision to terminate the employment or
- an employee's decision to accept an offer of benefits in exchange for the termination of employment.

Termination benefits do not Include,

- Employee benefits resulting from termination of employment ***at the request of the employee without an entity's offer***
- as a result of mandatory retirement requirements

7.1 Recognition of termination benefits

- Recognise a liability and expense for termination benefits

Fall due within 12 months	Liability in the balance sheet with a corresponding charge to profit and loss account
Fall due more than 12 months	Discounted using a appropriate discount rate

Termination benefits are recognized by an enterprise as a liability and an expense

a. Detailed formal plan for the termination which is duly approved and
b. Reliable estimate can be made of the amount of the obligation.

8 Disclosures

- Nature of Defined Benefit plans and effect of changes if any.
- Break up and reconciliation of different components of defined benefit obligation.
- Break up and reconciliation of different components or plan assets and return on assets.
- Expenses recognized in P& L Account in different components.
- Main Actuarial assumptions used

Disclosures required by other standards like AS-18, AS-29, AS-5 should also be made.

AS 9

Revenue Recognition

1 Scope of AS 9

- Timing for recognition of revenue in the financial statements; and
- State the circumstances under which revenue recognition should be postponed.

2 Recognition of Revenue

Revenue

gross inflow of cash, receivables, other consideration arising from

- Sale of Goods
- Rendering of Services
- Use by others of enterprise resources yielding interest,royalties and dividend

Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them.

- Revenue recognition emphasizes on the timing of recognition of revenue in the statement of profit and loss of an enterprise

- The amount of revenue arising from a transaction is usually determined by an agreement between the parties involved in the transaction

- When uncertainties arise regarding the determination of the amount or its associated costs, these uncertainties may influence the timing of the revenue

1. Agency Relationship

- Revenue is the amount of commission, not gross inflow of cash, receivables or other consideration
- Principal-agency relationship is significant for how much money can be recognised by entity for a sale
- Sale transaction made by an entity on its own, or on behalf of someone else.
- Risks and rewards
- Obligation to sell goods and services

2. Sale of Goods

In a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled-

- Seller has **transferred** to the buyer the **property in the goods** for a price
- all significant **risks and rewards** have been transferred to the buyer and seller retains no effective control of the goods transferred
- **no significant uncertainty** exists regarding the amount of the consideration that will be derived from the sale of the goods.

Example

A manufacturing company has the following stages of production and sale in manufacturing fine paper rolls:

Date	Activity	Cost to date	Net realisable value (Rs.)
15.1.21	Raw material pulp	1,00,000	80,000
20.1.21	Pulp (WIP 1)	1,20,000	1,20,000
27.1.21	Rough & thick paper (WIP 2)	1,50,000	1,80,000
15.2.21	Fine paper rolls	1,80,000	3,50,000
20.2.21	Ready for sale	1,80,000	3,50,000
15.3.21	Sale agreed and invoice raised	2,00,000	3,50,000
02.4.21	Delivered and paid for	2,00,000	3,50,000

Explain the stage on which you think revenue will be generated and state how much would the net profit for the year ending 31.3.21 on this product as per AS 9.

Answer -

According to AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

- the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and
- no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Thus, sales will be recognized only when following two conditions are satisfied:

(i) The sale value is fixed and determinable.

(ii) Property of the goods is transferred to the customer.

Both these conditions are satisfied only on 15.3.2021 when sales are agreed upon at a price and goods are allocated for delivery purpose through invoice. The amount of net profit Rs.150,000 (Rs.3,50,000 – Rs.2,00,000) would be recognized in the books for the year ending 31st March, 2021.

Examples of Revenue from sale of goods

Buyer requests delivery, but takes title and accepts billing	Recognise revenue even if delivery is not made, ensuring that the item is held in stock ready for delivery.
General warranties:	Revenue on sale is recognised, and provision is made based on past experience
Sale and repurchase agreements:	Examine 'substance over form'. Where a seller concurrently agrees to repurchase the same goods at a later date, it would amount to financing agreement. The cash flow is not an item falling within the ambit of 'Revenue'
Goods sold subject to installation and inspection:	Recognise revenue only when customer accepts delivery and installation is complete
Guaranteed sales (unlimited warranty):	Enquire into the substance of the agreement. If there is a 'money back' clause recognise revenue at the time of sale, but make a provision based on past experience of claims

3. Rendering of Services

Revenue from service transactions is usually recognised as the service is performed.

Methods of Recognition of Revenue

Proportionate completion method

- Recognition of revenue in statement of profit and loss proportionately with the degree of completion of services under a contract.
- Performance consists of the execution of more than one act.
- Revenue is recognised proportionately by reference to performance of each act.

Completed service contract method

- Recognition of revenue in the statement of profit and loss only when the rendering of services under a contract is completed or substantially completed.
- Services become chargeable.
- Performance consists of the execution of a single act.

Examples –

Advertising agency	Recognise media commission as revenue when the "ad" appears in the designated media
Insurance agency commission	Recognise as revenue on the effective date of issue, or renewal of policies
Commission for granting loans	Recognise revenue when a binding obligation emerges

1. Use of Enterprise Resources- Interest, Royalties and Dividend:

The use by others of such enterprise resources gives rise to:

1. **Interest**— charges for the use of cash resources or amounts due to the enterprise;
2. **Royalties**— charges for the use of such assets as know-how, patents, trademarks and copyrights;
3. **Dividends**— rewards from the holding of investments in shares

These are recognized when no significant uncertainty as to measurability or collectability exists.

Recognition of Revenue arising out of Interest, Royalties and Dividends:

- **Interest**: recognised on a time proportion basis taking into account the amount outstanding and the rate applicable
- **Royalties:** recognized on an accrual basis in accordance with the terms of the relevant agreement
- **Dividends:** recognized when the owner's right to receive payment is established.

4. Conditions for Sale of Goods

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

2.Sale on approval basis

3.Goods sold subject to inspection / installation

4.Sale and repurchase arrangement

5.Trade discounts and volume rebates

6.Cash discounts

7.Consignment sale

5. Effect of Uncertainties

- Where there is an uncertainty regarding ultimate collection of revenue **recognition is postponed** to the extent of uncertainty involved.

- When the uncertainty relating to collectability arises **subsequent to the time of sale or the rendering of the service** a **separate provision** is created to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

6. Exclusions from AS 9

AS 9 does not deal with revenue arising from -

- Construction Contracts
- Hire-purchase, lease agreements
- Government grants and other similar subsidies
- Insurance contracts of insurance companies

Examples of items not included in definition of "Revenue" for AS 9:

I. Realized gains on disposal of, and unrealized gain on holding of, non-current assets
II. Unrealized holding gains from change in value of current assets, and natural increases in herds and agricultural and forest products;
III. Realized or unrealized gains from changes in foreign exchange rates and adjustments arising on the translation of foreign currency financial statements;
IV. Realized gains on the discharge of an obligation at less than its carrying amount;
V. Unrealized gains from the restatement of carrying amount of obligation.

7. Special Points

Consignment Sale
Since risk & rewards are not transferred to the customer on mere delivery of goods so no revenue is recognised until the goods are sold to third party.

Sale on Approval
Revenue is not recognised until the goods are formally accepted by the buyer or time period for rejection has elapsed

Trade Discounts and volume rebates are deducted in determining revenue

In an **agency relationship**, the revenue is the amount of **commission** and not the gross inflow of cash, receivables or other consideration.

8. Disclosures

An enterprise should disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties along with the disclosures required by AS 1 "Disclosure of Accounting Policies"

9. Summary

Revenue
gross inflow of cash, receivables, other consideration arising from

- Sale of Goods
- Rendering of Services
- Use by others of enterprise resources yielding interest,royalties and dividend

Proportionate completion method

- Recognition of revenue in the statement of profit and loss proportionately with the degree of completion of services under a contract.
- Performance consists of the execution of more than one act.
- Revenue is recognised proportionately by reference to the performance of each act.

Completed service contract method

- Recognition of revenue in the statement of profit and loss only when the rendering of services under a contract is completed or substantially completed.
- Services become chargeable.
- Performance consists of the execution of a single act.

Postpone Revenue: When interest, royalties and dividends from foreign countries require exchange permission and uncertainty in remittance is anticipated, revenue recognition may need to be postponed.

Where there is an uncertainty regarding ultimate collection of revenue recognition is postponed to the extent of uncertainty involved.

Disclosure: Accounting Policy & Revenue postponed circumstances

AS – 7
Construction Contracts

1 Objective

A unique feature of construction contract is that it is carried out during more than one accounting year. So, the fundamental issue is – **allocation of revenue & costs** attributable to contract activity, to the accounting periods in which construction work is performed.

AS - 7 is **mandatory** to be applied in accounting for construction contracts **in the financial statement of contractors.**

AS - 7 prescribes:

- appropriate **accounting treatment** and
- appropriate **criteria for recognition** of these components in the statement of Profit and Loss following Matching concept and Prudence.

2 Construction Contract

2.1 Meaning:

Contract **specifically negotiated** for the construction of:

- An Asset
  - **Example:** bridge, building, dam, pipeline, road, ship or tunnel
- A combination of assets closely interrelated or interdependent in tems of their design, technology, function ot their ultimate use
  - **Example:** construction of refineries and other complex pieces of plant or equipment

Construction contracts also include:

- **Service contracts directly related to the construction of the asset** (Example: contract for the services of project managers and architects)

- Contracts for:
  - **destruction or restoration of assets**, and
  - **restoration of the environment** following the demolition of assets.

2.2 Types:

2.2.1 Fixed price contract:

Price

- A fixed sum
- A fixed rate per unit of output

The contract may require the customer to pay additional sums to compensate the contractor against cost escalations.

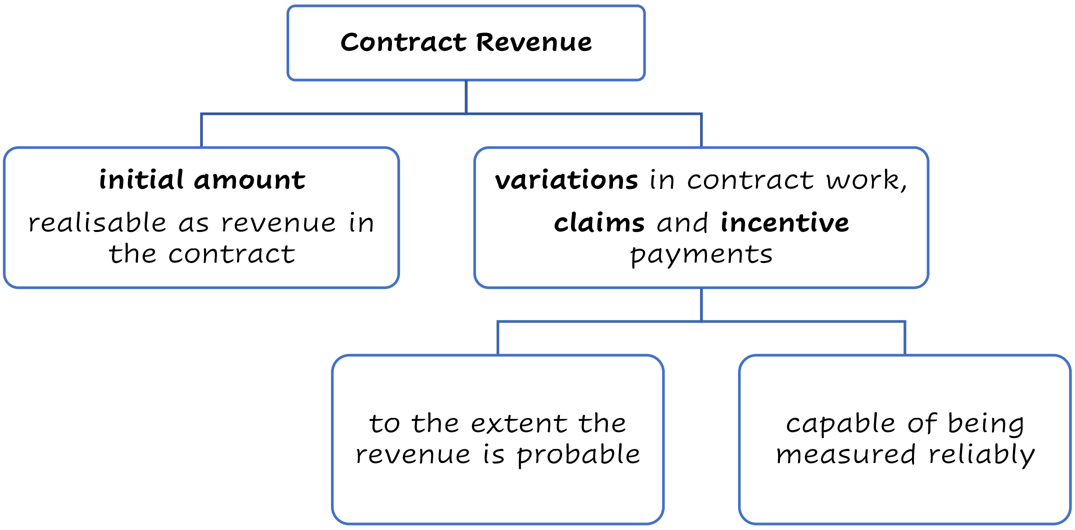
2.2.2 Cost plus contract:

Allowable costs + Percentage of these costs or a fixed fee = **Contract price**

Some construction contracts may contain characteristics of both a fixed price contract and a cost-plus contract.

3 Contract Revenue and Cost

3.1 Contract Revenue:



Variation: An instruction by the customer for a change in the scope of the work under the contract. A variation may lead to an increase or a decrease in contract revenue. Examples: changes in the specifications or design of the asset and changes in the duration of the contract.

Claim: An amount that the contractor seeks to collect from the customer or another party as reimbursement for costs not included in the contract price. Example: claim arising from customer caused delays, errors in specifications or design, and disputed variations in contract work.

Incentive payments: Additional amounts payable to the contractor if specified performance standards are met or exceeded. Example: a contract may provide for an incentive payment to the contractor for early completion of the contract.

Calculation of Contract Revenue:

Particulars	**₹**
Initial Contract Revenue agreed	xxx
+/- Variation in contract work	xxx
+ Incentive payments	xxx
+ Price escalation	xxx
+ Claims	xxx
- Any Penalty	xxx
Total Contract Revenue	**xxx**

3.2 Contract Costs:

Contract Costs

- **Directly relatable costs** (reduced by incidental income that is not included in contract revenue, e.g. sale of surplus material)
  - Example:
    1. site labour costs
    2. costs of materials used
    3. depreciation or cost of hiring plant and equipment used
    4. costs of design and technical assistance directly related to the contract
    5. claims from third parties
- Costs **allocable** to the contract (based on normal levels of construction activity)
  - Example:
    1. insurance
    2. costs of design and technical assistance indirectly related to the contract
    3. construction overheads
    4. borrowing costs as per AS 16
- Costs **specifically chargeable** to the customer
  - Example:
    A contract provides for hiring the services of a specific architect

Costs that cannot be attributed to contract activity or cannot be allocated to a contract are **excluded from the Costs of a construction contract**. Example:

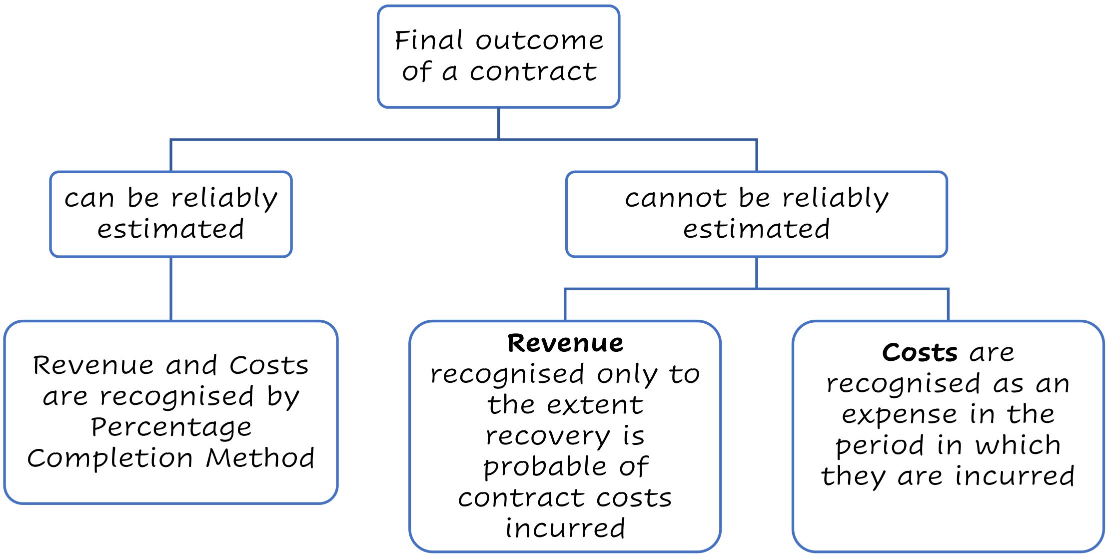
- general administration costs for which reimbursement is not specified in the contract
- selling costs
- research and development costs for which reimbursement is not specified in the contract
- depreciation of idle plant and equipment that is not used on a particular contract

4 Accounting Treatment

4.1 Recognition of Contract Revenue:

Since Construction contracts generally take more than one accounting year to complete, the final outcome (profit / loss) of a construction contract can be determined only after a number of years from the year of commencement of construction.

Recognition of contract revenue and costs depends on whether the final outcome of a contract can be reliably estimated or not.



When the final outcome of the contract can be reliably estimated to be loss, the expected loss has to be accounted for.

If there were some uncertainties due to which the outcome of the contract could not be reliably estimated but those uncertainties have ceased to exist now, the revenue and expense should be recognised by the percentage completion method.

Example:

A Contractor has just entered into a contract with a Local Municipal Body for building a Flyover. As per the contract terms, he will receive an additional Rs. 2 Crores, if the construction of the Flyover were to be finished within a period of two years of the commencement of the contract. He wants to recognize this revenue since in the past he has been able to meet similar targets very easily.

As per AS – 7, past track record is not a criteria for recognition of incentive payments receivable. In the above case the, the contract has not even begun. The Contractor should not recognize Incentive Income.

4.2 Conditions for estimating the final outcome of a contract:

4.2.1 For a 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 the **contract costs** to complete the contract and the **stage of contract completion** at the reporting date can be measured reliably, and
- the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

4.2.2 For a cost-plus contract:

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

Example:

X Ltd. commenced a construction contract on 01/04/X1. The contract price agreed was reimbursable cost plus 10%. The company incurred Rs. 1,00,000 in 20X1-X2, of which cost of Rs. 90,000 is reimbursable. The further non-reimbursable costs to be incurred to complete the contract are estimated at Rs. 5,000. The other costs to complete the contract could not be estimated reliably.

Since, the contract costs cannot be reliably estimated, the final outcome of this cost plus contract could not be estimated. Percentage of completion method is not to be applied in this case.

4.3 Percentage Completion Method:

It is possible to recognise revenue annually in proportion of progress of work (based on construction costs incurred) in that year. This method of accounting is called the **Stage of completion method (Percentage completion method)**.

Percentage of completion = $\frac{\text{Total Contract Costs incurred till date}}{\text{Total expected Cost of the Contract}} x\ 100$

Revenue to be recognised = Contract price x Percentage of Completion

4.4 Recognition of Expected Losses:

Expected Losses = Probable Total Contract Cost – Probable Total Contract Revenue

Expected Loss on Construction Contract → Recognise as an expense immediately.

The amount of such a loss is determined irrespective of:

- whether or not work has commenced on the contract,
- the stage of completion of contract activity, or
- the amount of profits expected to arise on other contracts which are not treated as a single construction contract.

4.5 Treatment of Costs Relating to Future Activity:

Under the percentage of completion method,

- contract revenue is recognised as revenue in the statement of profit and loss in the accounting periods in which the work is performed
- contract costs are usually recognised as an expense in the statement of profit and loss in the accounting periods in which the work to which they relate is performed.

The contract costs that relate to future activity on the contract are however **recognised as an asset** provided it is **probable that they will be recovered**.

Example:

To take advantage of bulk or volume discounts on purchase of construction materials, such as steel or cement, contractors sometimes buy significant quantities of those items and stock them at a site where a big construction contract is in progress.

The costs of such material are future costs because these are not meant for immediate consumption at the site where they are stored.

4.6 Uncollectable Contract Revenue:

When an uncertainty arises about the collectability of an amount already
- included in contract revenue, and
- recognised in the statement of profit and loss

→

The uncollectable / 'not probable to recover' amount is **recognised as an expense**

4.7 Changes in Estimates:

The percentage of completion method is applied on a cumulative basis in each accounting period to the current estimates of contract revenue and contract costs. So, the effect of a change in the:

- estimate of contract revenue or contract costs, or
- estimate of the outcome of a contract,

is **accounted for as a change in accounting estimate as per AS – 5**. 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.

4.8 Stage of Completion:

Contract period is spread over many years sometimes, so for every financial year one has to know the stage of completion to determine income and expenditure as per matching concept.

The stage of completion of a contract may be determined in a variety of ways. Depending on the nature of the contract, the enterprise uses the method that measures reliably the work performed.

Methods
- Proportion of contract costs till date to the estimated total contract costs
- Survey of work performed
- Completion of a physical proportion of the contract work

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

The recognition of revenue and expenses by reference to the stage of completion of a contract is often referred to as the percentage of completion method.

5 Combining and Segmenting Construction Contracts

A single contractor may undertake several contracts or several components in a contract. The standard explains when to apply the provisions:

- to the separately identifiable components of a single contract or
- to a group of contracts together to reflect the substance of a contract or a group of contracts.

5.1 A contract covers several assets, the construction of each asset should be treated as a separate construction contract when:

- **separate proposals** are submitted for each asset,
- each asset is **separate negotiated** and the contractor and customer can accept or reject part of the contract relating to each asset, and
- the **costs** and **revenues** of each asset can be **identified**.

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

- the group of contracts is **negotiated as a single package**,
- the contracts are so **closely interrelated** that they are, in effect, part of a single project with an overall profit margin, and
- the contracts are **performed simultaneously** or in a **continuous sequence**.

5.3 The construction of the additional asset under a contract should be treated as a separate construction contract when:

- the asset **differs significantly** in design, technology or function from the asset or assets covered by the original contract, or
- the price of the asset is **separately negotiated**.

6 Disclosures

6.1 Disclosure in respect of all contracts:

- **Disclose**
  - Contract **revenue**
    - Amount recognised
    - Method used to determine the amount recognised
  - Methods used to determine the **stage of completion** of contracts in progress

6.2 Disclosure in respect of all contracts in progress:

- **Disclose** (in amounts)
  - **Costs** incurred and **profits** recognised (less recognised losses) upto the reporting date
  - **Advances** received
  - **Retentions**

Retentions: Amounts of progress billings which are not paid until:
- the conditions specified in the contract are satisfied or
- defects have been rectified.

Progress billings: Amounts billed for work performed on a contract whether they have been paid by the customer or not.

Advances: Amounts received by the contractor before the related work is performed.

6.3 Disclosure of Gross amount due from/ to customers:

Disclose
- Asset
  - gross amount due **from** customers for contract work
- Liability
  - gross amount due **to** customers for contract work

Computation of Gross amount due from / to customers:

Particulars	**₹**
Costs incurred Plus: Recognised profits Less: Recognised losses Less: Progress billings	xxx xxx (xxx) (xxx)
Amount	xxx
If above amount is **positive**: Gross amount due from customers If above amount is **negative**: Gross amount due to customers	

Example:
Amount in Rs. Lakhs

Contract	**A**	**B**
Cost incurred till date	40	75
Add: Recognised profits	6	Nil
Less: Recognised losses	(Nil)	(13)
Less: Progress Billings	(36)	(70)
Amount	10	(8)
Nature	Asset	Liability

7 Summary

Methods for determining Stage of completion
(Choose depending on the nature of the contract)
- proportion of contract costs till date to the estimated total contract costs
- surveys of work performed
- completion of a physical proportion of the contract work

Contract Revenue = Initial amount realisable as revenue
+ Variations in contract work
+ Claims
+ Incentive payments

Contract Costs = Directly relatable costs

+ Costs allocable to the contract
+ Costs specifically chargeable to the customer

When contract costs relate to future activity, these are **recognised as an asset** provided it is probable that they will be recovered.

When an uncertainty arises about the collectability of an amount already
- included in contract revenue, and
- recognised in the statement of profit and loss,

the uncollectable amount is **recognised as an expense** rather than as an adjustment of the amount of contract revenue.

When there is a change in estimate, the changed estimates are used in determining 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**.

Outcome can be measured reliably when:

- **In Fixed Price contract**
  - probable that the **economic benefit** will flow to the enterprise
  - total **contract revenue** can be measured reliably
  - **contract costs** can be clearly identified and reliably measured
  - **stage of contract completion** at the reporting date can be measured reliably
- **In cost plus contract**
  - probable that **economic benefit** will flow to the enterprise
  - **contract costs** can be clearly identified and reliably measured

Percentage of completion = $\frac{\text{Total Contract Costs incurred till date}}{\text{Total expected Cost of the Contract}} x\ 100$

Revenue to be recognised = Contract price x Percentage of Completion

When the outcome of the contract can be reliably estimated to be loss (Contract Cost > Contract Revenue), the expected loss should be **recognised as an expense** immediately.

AS 13
Accounting For Investments

1.Scope of AS 13

The standard deals with accounting for investments in the financial statements of enterprises and related disclosure requirements.
The enterprises are required to disclose the current investments and long term investments distinctly in their financial statements.

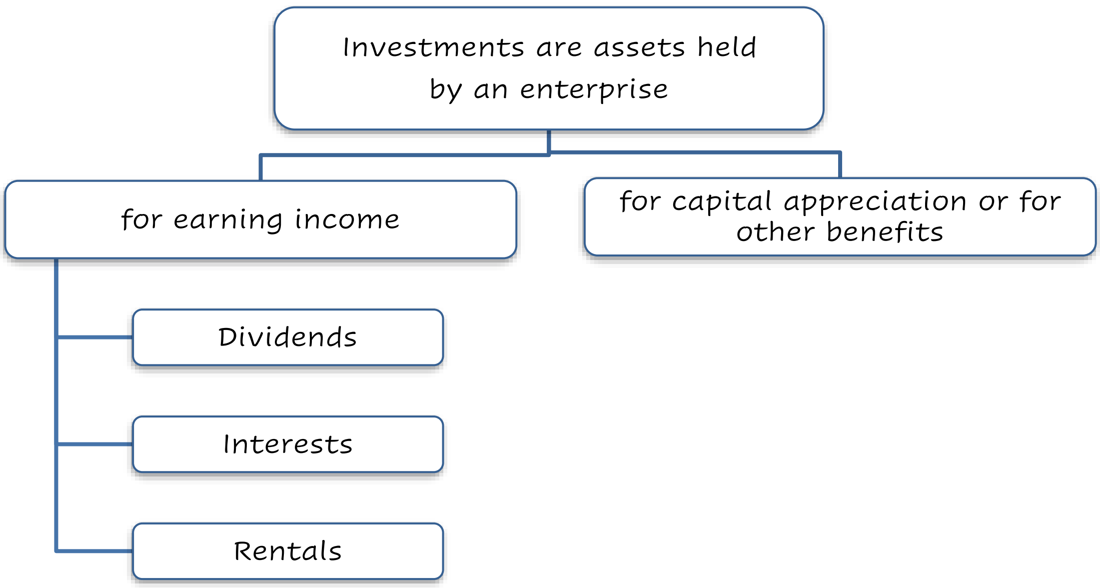
Exclusions
- Interest, Dividends and Rental Income earned on Investments held as stock in trade – AS 9
- Operating or Finance Leases – AS 19
- Investments on retirement benefit plan and life insurance enterprises
- Incorporate MF, Venture capital funds and related AMC, Banks and PFIs.

Example-
Sabka Bank has classified its total investment on 31-3-2021 into three categories (a) held to maturity (b) available for sale (c) held for trading.
Comment whether the policy of the bank is in accordance with AS 13?
Solution-
As per AS 13 'Accounting for Investments', the accounting standard is not applicable to Bank, Insurance Company, Mutual Funds. In this case Sabka Bank is a bank, therefore, AS 13 does not apply to it.

For banks, the RBI has issued guidelines for classification and valuation of its investment and Sabka Bank should comply with those RBI Guidelines/Norms.
Therefore, though Sabka Bank has not followed the provisions of AS 13, yet it would not be said as non-compliance since it is complying with the norms stipulated by the RBI.

2.Important Terms

Investments

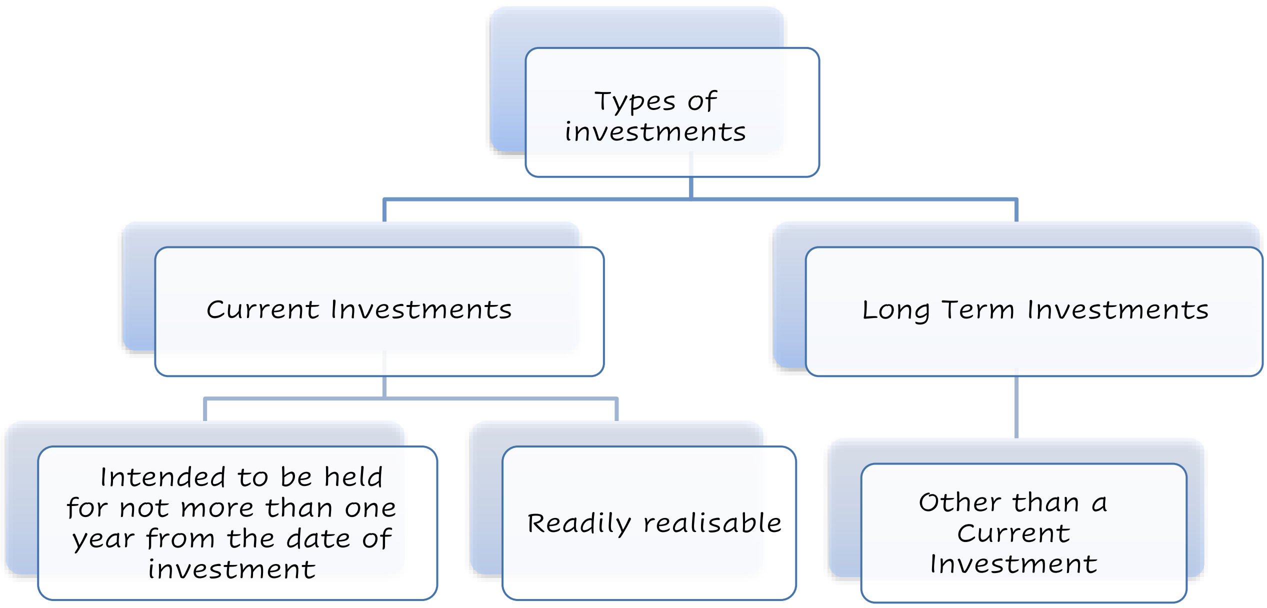


Fair Value (FV)
Amount for which an asset could be exchanged between a knowledgeable willing buyer and a knowledgeable willing seller in an arm's length transaction
Generally Market value is the fair value

Market Value (MV)
Market value is the amount obtainable from the sale of an investment in an open

market, net of expenses

3. Classification of Investments



Long term investment:

In the absence of a statutory requirement,such further classification should disclose

- Government or Trust securities
- Shares, debentures or bonds
- Investment properties
- Others - Specifying nature

4. Accounting for Investments

Determination of Cost of Investments:

The cost of an investment includes acquisition charges such as brokerage, fees and duties etc.

Investment acquired, or partly acquired, by the issue of shares or other securities, then acquisition cost is the fair value of the securities issued or asset given up

Investment acquired in exchange, or part exchange, for another asset, then acquisition cost of the investment is determined by reference to the fair value of the asset given up or the fair value of the investment acquired, whichever is more clearly evident.

- Acquired
  - Cash consideration
  - Non- cash consideration
    - By issue of shares/securities
      - For full value
      - For part value
    - By exchange of assets
      - For full value
      - For part value

Determination of Fair Value:

- Fair value is the amount for which an asset could be exchanged between a knowledgeable willing buyer and a knowledgeable willing seller in an arm's length transaction.
- For some investments, an active market exists from which a market value can be established. For such investments, market value generally provides the best evidence of fair value.
- For other investments, an active market does not exist and other means are used to determine fair value.

Treatment for Dividends / Interest

- Interest accrued/ Dividend declared
  - Pre-acquisition period
    - Deducted from cost of investment
  - Post-acquisition period
    - Recognized as an income

Accounting for Right Shares

- Right Shares
  - Subscribed
    - The cost of the right shares is added to the carrying amount of the original holding
  - Not Subscribed (i.e they are sold in open market)
    - Sale proceeds taken to P&L A/c

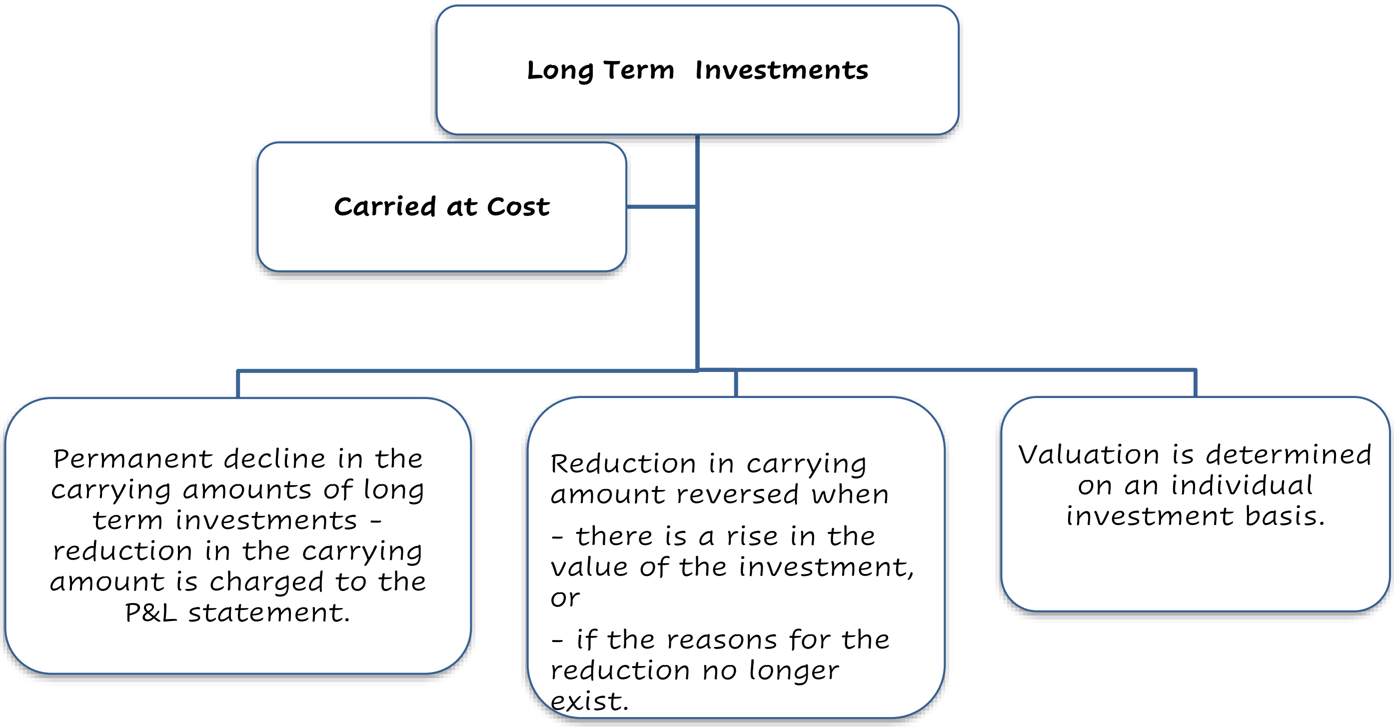
If acquired on cum-right basis & the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value.

Accounting for Bonus shares:

- No amount is entered in the capital column of the investment account with respect to the Bonus shares.

5. Determination of Carrying amount of Investments (Valuation)

- **Current Investments**
  - **Lower of Cost & Fair Value**
  - Reduction to FV is debited to profit and loss account
  - If FV of investment is increased, the increase in value of current investment up to the cost of investment is credited to the P&L
  - Valuation on overall (or global) basis is not considered appropriate; prudent method is to carry investment



Example -
An unquoted long-term investment is carried in the books at a cost of Rs.2 lakhs. The published accounts of the unlisted company received in May, 2021 showed that the company was incurring cash losses with declining market share and the long-term investment may not fetch more than Rs.20,000. Financial statements of 31st March, 2021 of investors are yet to be completed and approved by the Board of Directors.

Solution -
As per AS 13, Accounting for investment, long term investment should be valued at cost unless reduction is other than temporary. Here, cost of unquoted long-term investment was Rs.2,00,000, however, fair value of this investment is Rs.20,000 only
and this reduction is due to cash losses suffered by company with declining market share, which is other than temporary in nature.

On this basis, the facts of the given case clearly suggest that the provision for diminution of Rs.1,80,000 (Rs.2,00,000 - Rs.20,000) should be made to reduce the carrying amount of long term investment to Rs.20,000 in the financial statements as on 31st March, 2021.

6. Investment Properties

- An investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise.

- An investment property is accounted for in accordance with the cost model as prescribed in AS 10 (Revised), 'Property, Plant and Equipment'.

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

7. Disposal of Investments

- Difference between the carrying amount and the disposal proceeds, net of expenses, is recognised in the P & L statement.

> Credit to P&L(Profit) = (Sale proceeds – Selling expenses) - Carrying Amount
>
> Debit to P&L (Loss) = Carrying Amount – (Sale proceeds – Selling expenses)

- When part of an investment is disposed of, the carrying amount is allocated to that part on the basis of average carrying amount of the total investment.
- If investments held as stock-in-trade, cost of stocks disposed is calculated as per cost formula as per AS 2.

8. Reclassification of Investments

- Reclassification of Investments
  - Current to long-term → Transfer at lower of Cost or fair value
  - Long - term to Current → Transfer at lower of Cost or Carrying amount

Example-

i. Long term investments in Company A, costing Rs.8.5 lakhs are to be re-classified as current. The company had reduced the value of these investments to Rs.6.5 lakhs to recognize a permanent decline in value. The fair value on date of transfer is Rs.6.8 lakhs

Sol: In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at Rs. 6.5 lakhs in the book

ii. Current investment in Company C, costing Rs.10 lakhs are to be re-classified as long term as the company wants to retain them. The market value on the date of transfer is Rs.12 lakhs.

Sol: In this case, reclassification of current investment into long-term investments will be made at Rs.10 lakhs as cost is less than its market value of Rs.12 lakhs

9. Disclosure

Disclosures to be made in financial statements in relation to investments:

1. The accounting policies followed for valuation of investments.
2. The amounts included in profit and loss statement for:
   a. 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.
   b. Profits and losses on disposal and changes in carrying amount of
   - current investments
   - long term investments
3. Significant restrictions on
   - the right of ownership,
   - realisability of investments or
   - remittance of income and proceeds of disposal.

4. The aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments.
5. Other disclosures as specifically required by the relevant statute governing the enterprise.

10. Accounting for Investments

Proforma Investment Account

In the books of ________________

For the period from ______________________ to ___________________

Name of the scrip __________________

Date	Particulars	Nominal Value	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost

Note:

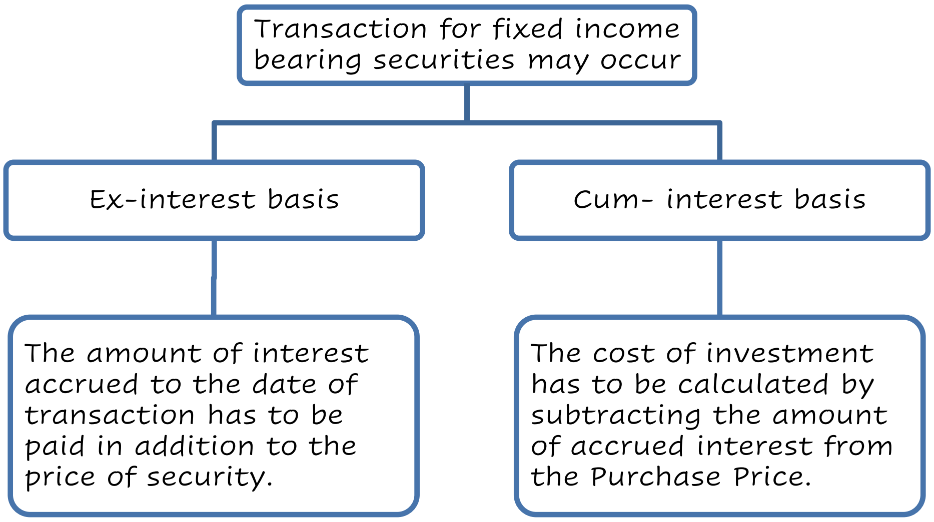
1. The 3rd Column (& 8th column) can contain either number of shares or nominal value of shares
2. Right shares renounced are not part of investment account. They are directly shown in the P&L.
3. Interest amount is always calculated with respect to nominal value (par value/ nominal value)

COST OF INVESTMENTS

Scenarios	**Cost**
If investment is acquired	Acquisition price + brokerage + duties + any other fees
Investment is acquired by issue of shares or other securities	Fair value of securities issued Note - The fair value may not necessarily be equal to the nominal or par value of the securities issued.
Investment is acquired in exchange of or part exchange of any other asset	Fair value of asset given up OR Fair value of investment received (whichever is clearly evident)
Investment is acquired cum-interest	Interest portion is deducted from cost. A part of purchase price is related to the interest accrued from the date of the last interest paid to the date of transaction
Investment is acquired ex-interest	Cost = Acquisition price. As interest is not part of the price. However, we need to calculate the interest and pay it along with the investment.
Bonus shares	Cost = Nil. Only number of shares increases
Right Shares - When rights are subscribed	Cost = Rights value This is added to the carrying amount of investment
Right Shares - If rights are sold in the market and are not subscribed	The sale proceeds are credited to P&L

Note - Where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the

cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value.	
Investment properties - in case of co-operative society	cost of property + cost of shares (if shares are necessary to acquire the investment property)



Journal entries	
When investment is purchased	
Investment A/c	Dr.
Interest Accrued A/c	Dr.
To Bank A/c	

Note:

1. In case the transaction is ex-interest basis, the Investment A/c is debited with the price settled on ex-interest basis.
2. In case the transaction is cum-interest basis, the Investment A/c is debited with the price settled on cum-interest basis less interest accrued.
3. Interest accrued is calculated from the previous due date to date of transaction.
4. When the interest amount is actually received, it is entered in the Income Column credit side. The net effect of these entries will be that the amount credited to the income will be only the interest arising between the date of purchase and the one on which its next fall's due.
5. In case the quotation does not specify whether it is ex-interest or cum-interest, the same will be treated as ex-interest quotation as per the general practice.

Interest / Dividend

- Pre-acquisition
  - The amount of dividends for the period, for which the shares were not held by the investor - treated as Capital receipt
  - Deduct from the value of investment
- Post - acquisition
  - The amount of dividends for the period, for which the shares were held by the investor- treated as Revenue receipt
  - Credited to P&L

11. Summary

Scope: AS 13 provides a basis for classification of Investments into current and long term and deals with the accounting and disclosure requirements for investments

Measurement:

- Current investments are measured at lower of cost and fair value
- Long term investments are measured at cost. Provide for permanent decline in value.

Dividends:

- Pre acquisition dividend - deducted from the cost of investments
- Post acquisition dividends -recognised as income

Right shares: When right shares are subscribed cost of shares is added to their carrying amount but if they are sold in open market then the sale proceeds are taken to P&L account

Bonus shares: Cost of acquisition is NIL

Valuation: Individual investment basis is preferred over global basis

Re-classification of Investments:

- Current to long term- Lower of cost and fair value as on the date of transfer
- Long term to current –Lower of cost and carrying amount as at date of transfer

AS 11
The Effects of Changes in Foreign Exchange Rates

1. Scope of AS 11

AS 11 deals with the issues of deciding which exchange rate to use and how to recognise the financial effects of changes in exchange rates in the financial statements

1.1. Applicability

a) Accounting for transactions in foreign currency.
b) Translating financial statements of foreign operation
c) Accounting for foreign currency transactions in the nature of <u>forward exchange contracts.</u>

1.2. Non –Applicability

AS 11 doesn't specify the currency in which an enterprise presents its financial statements. However, an enterprise normally uses the currency of the country in which it is domiciled. If an entity currency different from its domestic currency, it has to disclose the reason. The Standard also requires disclosure of the reason for any change in the reporting currency.

a. Presentation in a <u>cash flow statement</u> of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation (addressed in AS 3)
b. Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an <u>adjustment to interest costs (AS-16).</u>
c. Restatement of an enterprise's financial statements from its <u>reporting currency into another currency</u> for the convenience of users accustomed to that currency or for similar purposes.

2. Definitions

1. Monetary Items

Money held and assets and liabilities to be received or paid in fixed or determinable amounts of money. For example, cash, receivables and payables.

2. Non- Monetary Items

Assets and liabilities other than monetary items.
For example, fixed assets, inventories and investments in equity shares.

3. Exchange Difference

Difference resulting from reporting the same number of units of a foreign currency in the reporting currency at a different exchange rate.

4. Foreign Operation

Foreign operation is a subsidiary, associate, joint venture or branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.

5. Integral Foreign Operation

Foreign operation, which is an integral part of those of the reporting enterprise. It carries on its business as if it were an extension of the reporting enterprise's operations.
For example, such an operation might only sell goods imported from the reporting enterprise and remits the proceeds to the reporting enterprise.

6. Non-Integral Foreign Operation (NFO)

Foreign operation that is <u>not an integral foreign operation.</u> 'Net investment in a non-integral foreign operation' is the reporting enterprise's share in the net assets of that operation.

7. Forward Exchange Contract

It is an agreement to exchange different currencies at a specified rate in future.

8. Foreign Currency

'Foreign currency' is a currency other than the reporting currency of an enterprise.
Example – A company in India will have rupees (₹) as reporting currency and US Dollars ($) as foreign currency.

3.Foreign Currency Transactions

3.1. Meaning

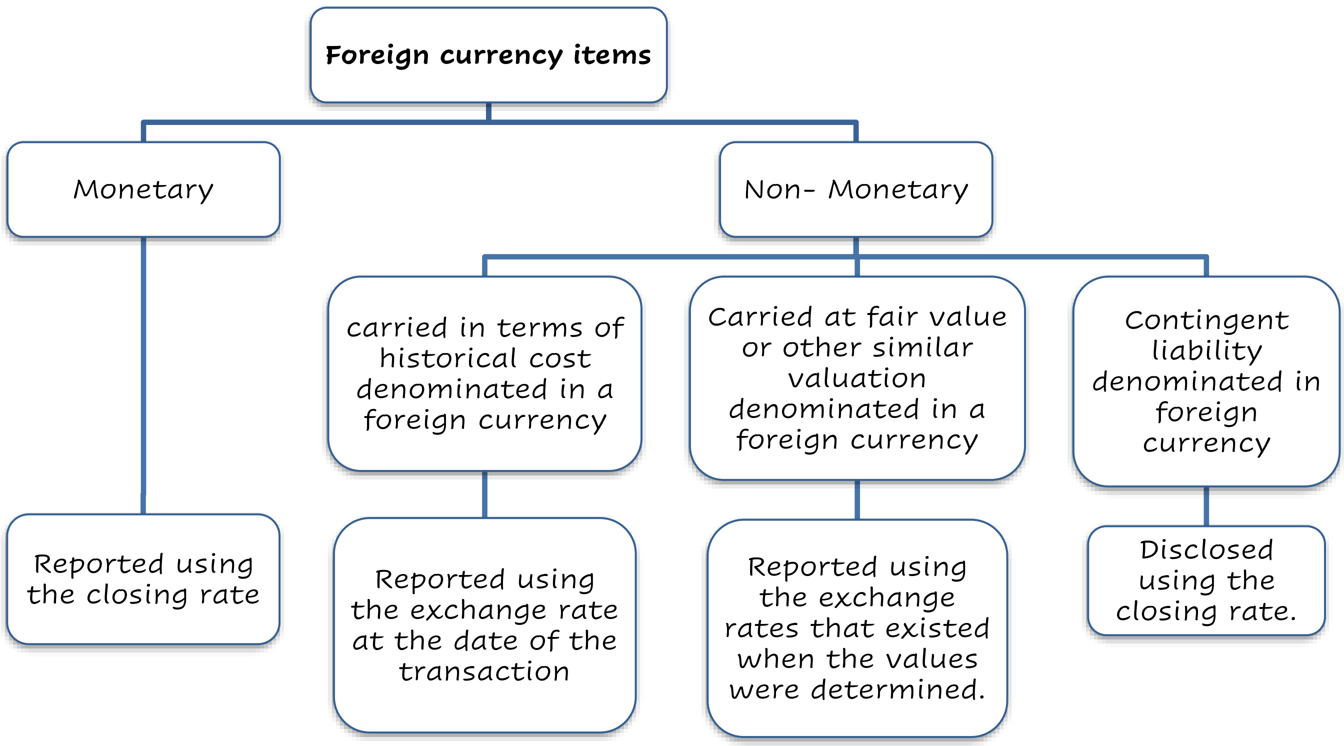
A foreign currency transaction is a transaction which is denominated in or requires settlement in a foreign currency.
It includes transactions arising when an enterprise either:

a) Buys or sells goods or services whose price is denominated in a foreign currency.
b) Borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency.
c) Becomes a party to an unperformed forward exchange contract or
d) Otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

3.2. Initial Recognition

A foreign currency transaction should be recorded, on initial recognition in the <u>reporting currency,</u> by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency <u>at the date of the transaction</u>

4. Reporting At Each Balance Sheet Date



5.Recognition of Exchange Difference

An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of any monetary items arising from a foreign currency transaction.

Exchange differences arising on

- the settlement of monetary items or

- monetary items of an enterprise (as monetary items are reported at rates different from those at which they were initially recorded during the period), or
- monetary items reported in previous financial statements,

should be recognized as income or as expenses in the period in which they arise.

6. Recognition of transactions

Settlement	Recognition
Transaction is settled within the same accounting period as that in which it occurred	All the exchange difference is recognised in that period
Transaction is settled in a subsequent accounting period	Exchange difference recognised in each intervening period up to the period of settlement is determined by the change in exchange rates during that period

7.Long-term foreign currency monetary items

7.1.Depreciable Asset

Exchange differences arising on reporting of long-term foreign currency monetary items at rates different from

- those at which they were initially recorded during the period, or
- reported in previous financial statements,

In so far, they relate to the acquisition of a depreciable capital asset, can be

- added to or
- deducted from

the cost of the asset and should be depreciated over the balance life of the asset;

7.2.Others

In other cases, exchange difference can be accumulated in the Foreign Currency Monetary Item Translation Difference (FCMITDA) Account and (amortised over the balance period of such long term assets or liability, by recognition as income or expense in each of such periods)

8.Para 46 and 46A – Applicable to Long Term Foreign Currency Monetary Item

Initially, all the exchange differences were to be taken to the profit or loss statement. However, the Union Government of India, vide its notification issued on March 31st, 2009, inserted the para 46 (with retrospective effect from 2006) in the "AS 11 The Effects of Changes in Foreign Exchange Rates".

Foreign exchange gains or losses on Long Term Foreign Currency Monetary Items are treated as below

In case of Depreciable Asset	In Other cases
Can be added to / reduced from cost of asset	Accumulate in Foreign Currency Monetary Items Translation Difference Accounts (FCMITDA)
Depreciation is calculated based on revised amount	The balance in FCMITDA account is amortised over the balance life of asset/liability

9.Classification of Foreign Operations as Integral or Non-integral

The method used to translate the financial statements of a foreign operation depends on the way in which it is financed and operates in relation to the reporting enterprise. Foreign operations are classified as either 'integral foreign operations' or 'non-integral foreign operations

- Foreign operations
  - Integral foreign operations
  - Non integral foreign operations

10.Indications that a FO is a NFO

- A foreign operation should have a significant degree of independence in its activities.
- Transactions with reporting entity are not large in number
- Cost of material, labour and other expenses are paid or settled in its local currency.
- Sales are mainly not in reporting currency.
- Sale prices are determined based on its local competition and local regulations.
- Activities are funded either from profit from its own operations or from local borrowings.

11. Translation of Integral Foreign Operations (IFO)

- Translation
  - Individual items in financial statements
    - Translated as if all transactions had been entered into by reporting enterprise
  - Cost & depreciation of tangible fixed
    - Exchange rate at date of purchase
  - Cost of inventories
    - Existing rates when those costs were incurred.
  - Recoverable amount of an asset
    - Exchange rate that existed when recoverable amount was determined

12. Translation of Non-Integral Foreign Operations (NFO)

Translation

Assets and Liabilities	Income and expenses	Exchange differences	Goodwill/ Capital Reserve	Contingent Liability
Closing rate	Exchange rate on date of transaction	Accumulated in Foreign currency translation reserve account	Closing rate	Closing rate

Consolidation of Reporting Enterprise

Exchange difference arising on an intra-group monetary item, whether short-term or long-term, cannot be eliminated against a corresponding amount arising on other intra-group balances.
In the consolidated financial statements of the reporting enterprise, such an exchange difference continues to be recognised as income or an expense or, if it arises from the circumstances described in paragraph 15, it is accumulated in a foreign currency translation reserve until the disposal of the net investment.

Different reporting dates

When the financial statements of a non-integral foreign operation are drawn up to a different reporting date from that of the reporting enterprise, the assets and liabilities of the non-integral foreign operation are translated at the exchange rate at the balance sheet date of the non-integral foreign operation and adjustments are made when appropriate for significant movements in exchange rates up to the balance sheet date of the reporting enterprise.

13. Reclassification of a Foreign Operation

- When there is a change in the classification of a foreign operation, the translation procedures applicable to the revised classification should be applied from the date of the change in the classification.

- When a foreign operation that is integral to the operations of the reporting enterprise is reclassified as a non-integral foreign operation, exchange differences arising on the translation of non-monetary assets at the date of the reclassification are accumulated in a foreign currency translation reserve.

- When a non-integral foreign operation is reclassified as an integral foreign operation, the translated amounts for non-monetary items at the date of the change are treated as the historical cost for those items in the period of change and subsequent periods. Exchange differences which have been deferred are not recognised as income or expenses until the disposal of the operation.

14. Disposal of Non-Integral Foreign Operation

On the disposal of a non-integral foreign operation, the cumulative amount of the exchange differences which have been deferred and which relate to that operation should be recognised as income or as expenses in the same period in which the gain or loss on disposal is recognised.

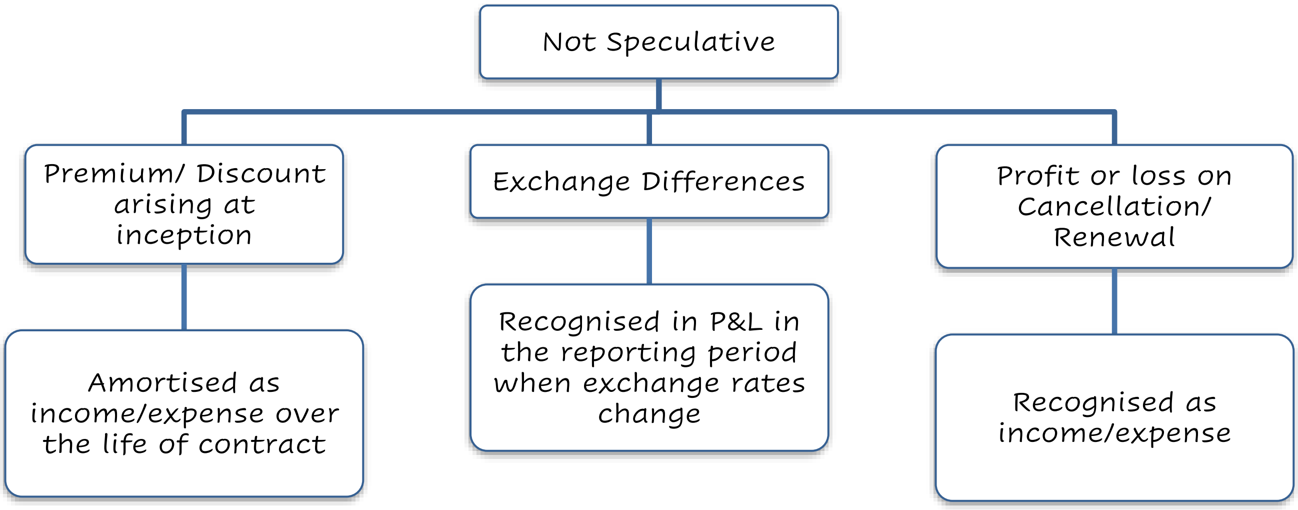
A write- down of the carrying amount of a non-integral foreign operation does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognised at the time of a write-down.

15. Tax Effects of Exchange Differences

Gains and losses on foreign currency transactions and exchange differences arising on the translation of the financial statements of foreign operations may have associated tax effects which are accounted for in accordance with AS 22.

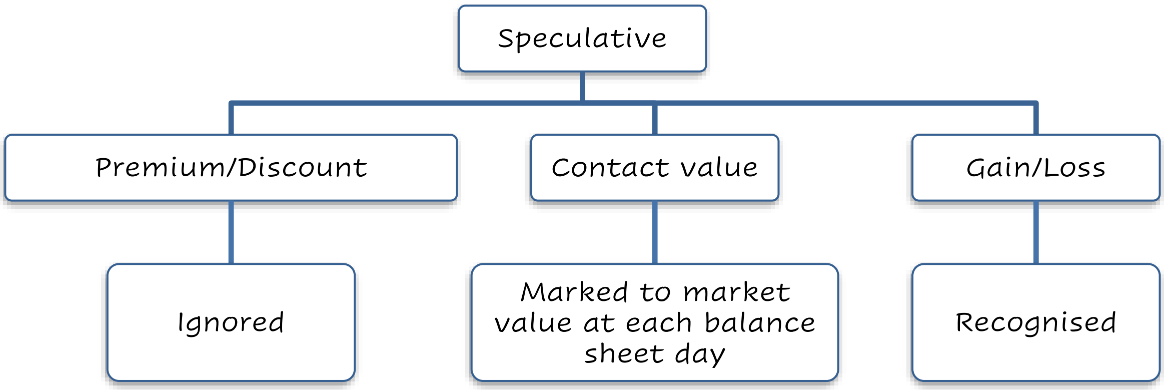
Forward Exchange Contract

Non-Speculative Forex Contract



Speculative Forex Contract

Gain / Loss = Foreign currency amount in contract X (forward rate at the reporting date - the contracted forward rate/ forward rate last used).



16. Disclosure

An enterprise should disclose:
(a) The amount of exchange differences included in the net profit or loss for the period
(b) Net exchange differences accumulated in foreign currency translation reserves as a separate component of shareholders' funds, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.
When the reporting currency is different from the currency of the country in which the enterprise is domiciled, the reason for using a different currency should be disclosed. The reason for any change in the reporting currency should also be disclosed.

When there is a change in the classification of a significant foreign operation, an enterprise should disclose:
(a) The nature of the change in classification;
(b) The reason for the change;
(c) The impact of the change in classification on shareholders' funds; and
(d) The impact on net profit or loss for each prior period presented had the change in classification occurred at the beginning of the earliest period presented.

Presentation of Foreign Currency Monetary Item Translation Difference Account (FCMITDA)

FCMITDA is open for exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, insofar as they relate to the acquisition of a non-depreciable capital asset.

Debit or credit balance in FCMITDA should be shown on the "Equity and Liabilities" side of the balance sheet under the head 'Reserves and Surplus' as a separate line item.

AS – 22
Accounting for Taxes on Income

1 Scope

This standard prescribes the accounting treatment of taxes on income and follows the **Matching concept** (matching expenses against revenue for the period).

Often, the taxable income may be significantly different from the income reported in the financial statements due to the **difference in treatment of certain items:**

- under taxation laws, and
- in the books of accounts.

1.2 Definitions:

Accounting income / (loss) is the net profit or loss (before Income Tax) for a period, as reported in the statement of profit and loss.

Taxable income / (loss) is the amount of the income / (loss) for a period, as per the tax laws. Income-tax payable / (recoverable) is determined based upon this income / (loss).

Current tax is the amount of income tax (domestic as well as foreign taxes) determined to be payable / (recoverable) in respect of the taxable income / (tax loss) for a period.

Note: The payment under MAT provisions of the Income Tax Act is a current tax for the period.

Deferred tax is the tax effect of timing differences.

Note: Deferred Tax Assets / Liabilities should be measured using the regular tax rates and not the tax rate applicable for MAT.

Tax expense / (tax saving) is the overall cost related to income tax.

Current Tax	Taxable income x Tax rate	
Deferred Tax	Timing difference x tax rate	
Tax Expense	Current + Deferred Tax	

2 Differences between Accounting Income and Taxable Income

2.1 Types

Types of Differences

Timing Differences

Differences that originate in one period and are **capable of reversal** in one or more subsequent periods.

(These result in deferred tax asset / liability)

Permanent Differences

Differences that originate in one period and **do not reverse** subsequently.

(These do not result in deferred tax asset / liability)

2.2 Some examples of differences between taxable and accounting income.

Basis	Accounting Income	Taxable Income	Type of Difference	Example
Governing Law	Computed as per **Accounting Standards / Companies Act / Ind AS**	Computed as per **Income-tax Act, 1961**		
Depreciation	Based on method & rates under accounting standards (SLM/WDV)	Based on rates & method prescribed in Income-tax Act (mostly higher WDV)	**Temporary Difference**	Depreciation in books: ₹4,00,000; Tax depreciation: ₹7,20,000
Disallowed Expenses	Charged to P&L	Disallowed under tax law	**Permanent Difference**	Penalty paid
Exempt Incomes	Credited in P&L	Exempt under Income-tax Act	**Permanent Difference**	Agricultural income
Recognition Basis	Follows **accrual** principle	May follow **receipt**/specific recognition as per tax law	**Temporary Difference**	Bonus paid to employees allowed on payment basis
Provisions & Reserves	Created in books on estimated basis	Allowed only on actual payment or specific conditions	**Temporary Difference**	Provision for gratuity, doubtful debts
Govt. Grants / Subsidies	May be treated as deferred income in books	Taxable in year of receipt (unless exempt)	**Temporary Difference**	Subsidy received for setting up industry

Example – 1 Basic computation of DTA/DTL based on depreciation

A company purchased an item of PPE for Rs. 12,00,000. The company has profit before Depreciation and Tax of Rs. 10,00,000 each year.

The company provides depreciation on SLM basis over useful life of 3 years. However for income tax purposes, the machine is depreciated at 25% in Year 1, 60% in year 2 and 15% in year 3.

Year	***1***	***2***	***3***
Profit before Dep & Tax	10,00,000	10,00,000	10,00,000
Less: Depreciation (1200000/3)	(4,00,000)	(4,00,000)	(4,00,000)
Accounting income before tax	6,00,000	6,00,000	6,00,000
Less: Tax expense			
Current Tax	(1,75,000)	(70,000)	(2,05,000)
Deferred Tax	25,000	(80,000)	55,000
Total Tax expense	(1,50,000)	(1,50,000)	(1,50,000)
Profit after tax	4,50,000	4,50,000	4,50,000
Taxable Income			
Profit before Dep & Tax	10,00,000	10,00,000	10,00,000
Less: Tax Depreciation	25%	60%	15%
	(3,00,000)	(7,20,000)	(1,80,000)
Taxable Income	7,00,000	2,80,000	8,20,000
Tax rate	25%	25%	25%
Current Tax	1,75,000	70,000	2,05,000
Difference in Depreciation	1,00,000	(3,20,000)	2,20,000
Tax Impact	25,000	(80,000)	55,000
Deferred Tax Impact	Asset	Liability	Reversal
Closing balance	25,000	(55,000)	–

Example 2 : (You will understand actual provisions in Taxation)

The **Profit before Tax** of **A Limited** for the year ended **31st March, 2022** is **₹25,00,000**. The applicable **Income Tax Rate** is **35%**. The following adjustments are to be considered while reconciling accounting profit with taxable income:

1. **Depreciation**
    - Depreciation charged in the Books of Accounts: **₹7,42,900**
    - Depreciation allowable under the Income Tax Act: **₹8,65,400**
2. **Provision for Doubtful Debts**
    - A provision of **₹54,300** has been created in the Books.
    - The same is **not allowable** as deduction under the Income Tax Act.
3. **Preliminary Expenses**
    - The company has **unamortised preliminary expenses** of **₹6,23,500** as per tax records.
    - These will be eligible for deduction under the Income Tax Act in future years.
4. **Donation**
    - Donation of **₹2,00,000** has been debited to the Profit & Loss Account.
    - Under the Income Tax Act, **only 50% (₹1,00,000)** is allowable as deduction.

Particulars	Amount (₹)	Nature of Difference	Treatment	Deferred Tax @ 35% (₹)
Profit before Tax (Books)	25,00,000			
Less: Depreciation (7,42,900 – 8,65,400)	(1,22,500)	Timing	Deferred Tax Liability	(42,875)
Add: Provision for Doubtful Debts	54,300	Permanent	Ignored	–
Add: Unamortised Preliminary Expenses	6,23,500	Timing	Deferred Tax Asset	2,18,225
Add: Donation disallowed (50% of 2,00,000)	1,00,000	Permanent	Ignored	–
Total Income as per IT Act	**31,55,300**			
			Net Deferred Tax Asset	**1,75,350**

Examination Tip

Due to differences	**Present**	**Future**	**Creation of**
Tax payable	Higher	Lower	Deferred Tax Asset
Tax Payable	Lower	Higher	Deferred Tax Liability

If depreciation for tax purposes is lower as compared to accounting depreciation, the taxable income will be higher resulting in higher tax now. In future when depreciation for tax is higher, tax payable would be lower. Hence, the entity will recognise as Deferred Tax Asset now.

3 Accounting Treatment

3.1 Recognition of Tax Expense:

Taxes on income are considered to be an **expense** incurred by the enterprise in earning income. Based on the matching concept, these are **accrued in the same period** as the revenue and expenses to which they relate.

The tax effects of timing differences are included:

- in the statement of profit and loss – as tax expense, and
- in the balance sheet - as deferred tax assets / deferred tax liabilities.

Prudence:

Deferred tax assets should be recognised only to the extent that there is a **reasonable certainty of their realisation**, which can be known by examining the past record of the enterprise and by making realistic estimates of profits for the future.

Virtual certainty regarding future taxable income:

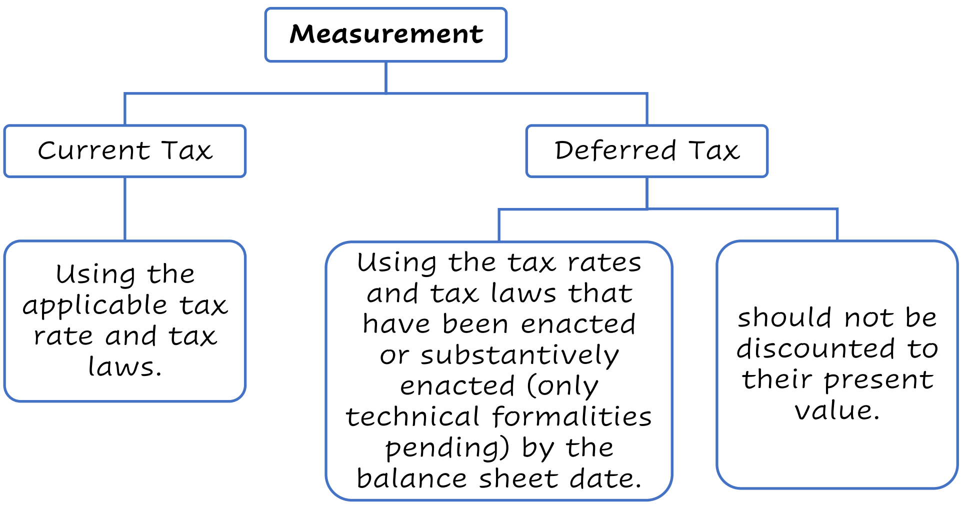
Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is **virtual certainty supported by convincing evidence, and not merely on forecasts of performance** that sufficient future taxable income will be available against which such deferred tax assets can be realised.

The evidence should be definite and available at the reporting date.

Example: A profitable binding export order, cancellation of which will result in payment of heavy damages by the defaulting party.

On the other hand, a projection of the future profits made by an enterprise cannot, in isolation, be considered as convincing evidence.

3.2 Measurement:



Note: If there are different tax rates for different levels of income, average rates should be used.

3.3 Accounting Entries:

(a) For Deferred Tax Liability: Profit & Loss Account ..... Dr.
To Deferred Tax Liability Account

(b) For Deferred Tax Asset: Deferred Tax Asset Account .... Dr.
To Profit & Loss Account

3.4 Transitional Provisions:

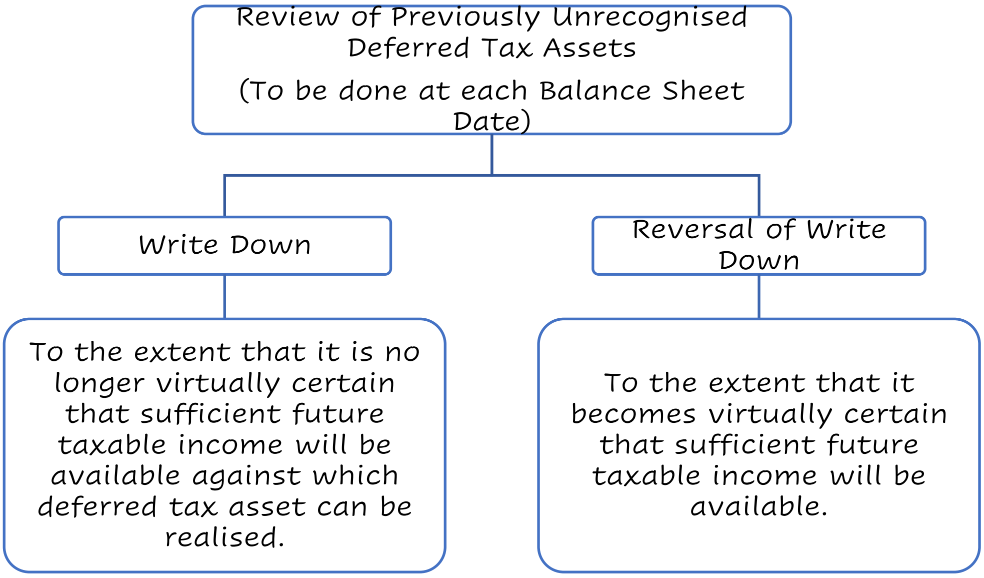
For the first time, the enterprise should recognise the deferred tax **balance that has accumulated** prior to the adoption of this Standard as deferred tax asset / liability with a corresponding credit / charge to the revenue reserves in the financial statements.

The amount so credited / charged to the revenue reserves should be the same as that which would have resulted if this Standard had been in effect from the beginning.

3.5 Re-assessment of Unrecognised Deferred Tax Assets:

- To be done **at each balance sheet date**.
- The previously unrecognised deferred tax assets are to be realized only to the extent that it has become **virtually certain that sufficient future taxable income will be available** against which such deferred tax assets can be realised.

3.6 Review of previously recognised Deferred Tax Assets:



4 Disclosures

4.1 In the Statement of Profit & Loss:

- **No specific requirement to disclose** current tax and deferred tax.
- **No reconciliation** between accounting profit and the taxable income is required.

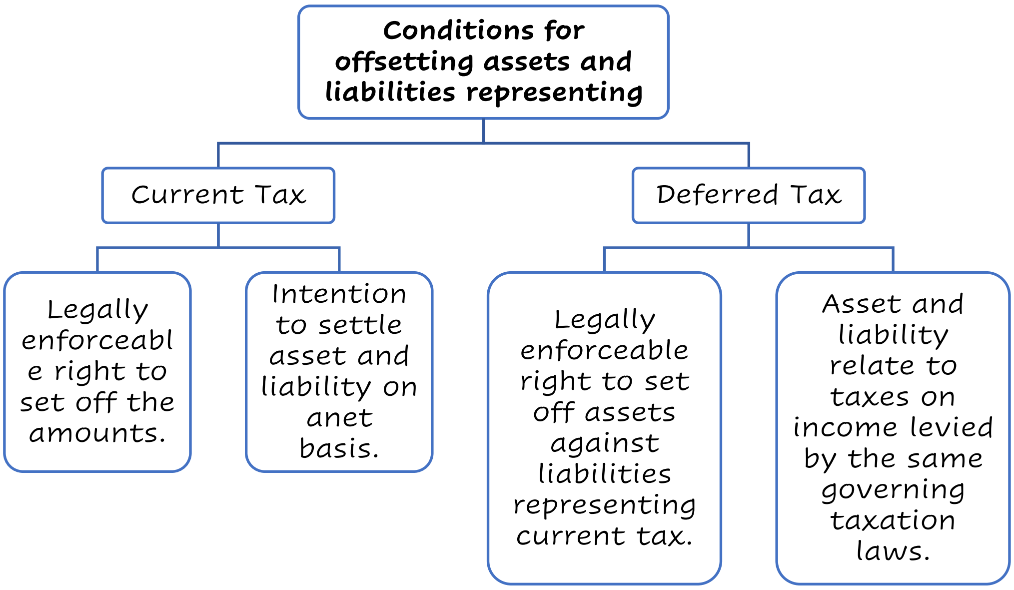
Note: Under the Companies Act, 2013, the amount of income tax and other taxes on profits should be disclosed.

4.2 In the Balance Sheet:

- Deferred tax assets and liabilities should be **distinguished from current tax** and **disclosed under a separate heading** in the balance sheet separately from current assets and current liabilities.
  (As per Schedule III of the Companies Act, 2013, Deferred Tax Assets or Liabilities are disclosed in Non – Current Assets or Liabilities as a separate line item)

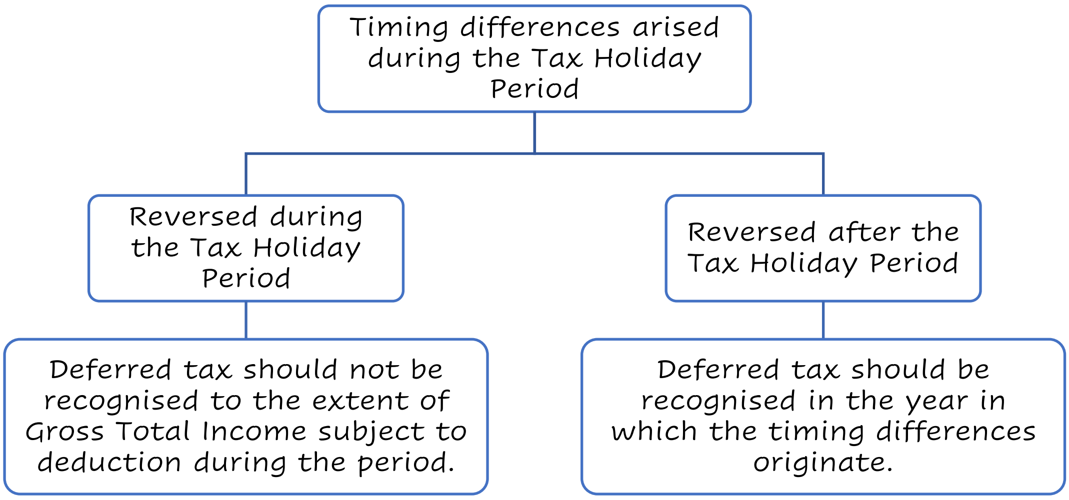
- The **break-up** of deferred tax assets and deferred tax liabilities into major components of the respective balance should be disclosed in the notes to accounts.

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



5 Explanations

5.1 Tax Holiday Under Income Tax Act



For the above purposes, the timing differences which originate first should be considered to reverse first (FIFO Basis).

5.2 Minimum Alternate Tax

MAT (Minimum Alternate Tax) is a **provision under the Income Tax Act** that requires companies to pay a minimum amount of tax even if their **taxable income under normal provisions is very low** due to exemptions, deductions, or incentives.

It ensures companies **pay a minimum level of tax** despite claiming deductions under the Income-tax Act. The difference between MAT paid and tax payable as per normal provisions can be set off in future years as credit and hence such difference is recognised as an Asset in the balance sheet.

Accounting entry	MAT paid is recognized as **an** because it **can be set off against future normal tax liability** (MAT credit can be carried forward). MAT Credit A/c Dr xxxx (Asset) To Profit & Loss xxxx (Reduced from Tax Expense)

Recognition	**MAT credit entitlement** is recognized as **asset** in the balance sheet to the extent **it is probable that the company will have future taxable profits** to utilize it.

Example: For B Limited, following information is given:

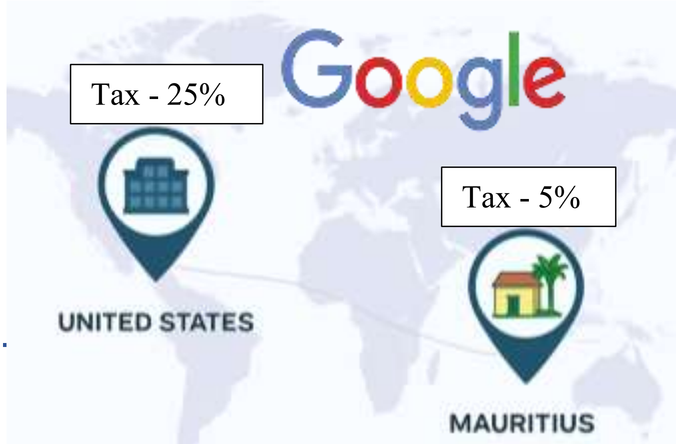
Particulars	**Rs.**
Accounting Profit	6,00,000
Profit as per Income Tax	60,000
Tax Rate	20%
Book Profit as per MAT	3,50,000
MAT Rate	7.50%

Current Tax (normal provisions)	60,000 x 20% = 12,000	
Minimum Tax payable (MAT)	3,50,000 x 7.5% = 26,250	
Excess MAT available as credit	26,250 – 12,000 = 14,250	Shown as asset & Credited to PL
Timing difference	5,40,000	
Deferred Tax Liability	5,40,000 x 20% = 1,08,000	

Presentation in Profit & Loss

Current Tax	26,250
Deferred Tax	1,08,000
Total	**134,250**
Less: MAT Credit	(14,250)
Tax expense	1,20,000

5.3 Pillar 2 Taxes



Background

- The world's biggest companies (like Google, Apple, Amazon) earn profits in many countries.
- Some of these companies **pay very little tax** by shifting profits to **low-tax countries**.
- To stop this, over **135 countries**, including India, are working with the **OECD (Organisation for Economic Co-operation and Development)** on **"Global Minimum Tax Rules."**

What Is Pillar Two?

- **Pillar Two** is one part of this global initiative.
- It introduces a **Global Minimum Tax** of **15%** for **large multinational companies** with revenue over €750 million.
- If a company pays less than 15% in one country, the group will have to **"top up"** the tax to reach 15%.

How Pillar Two Works – A Simple Example

Let's say:

- A global company operates in Country X.
- Country X has a corporate tax rate of **5%**.
- According to Pillar Two, if the **effective tax rate** in Country X is below 15%, then the **parent company** must **pay additional tax (top-up tax)** so that the overall tax becomes 15%

Even though no DTA/DTL is created, companies must still **disclose** the following:

Para	What to Disclose
32A	State that the entity has applied the **exception** (i.e., no DTA/DTL for Pillar Two taxes)
32B	Disclose the **current tax expense/income** related to Pillar Two taxes **separately**
32C	If Pillar Two laws are **enacted but not yet effective**, disclose **estimated impact and exposure**
32D	Disclose both **qualitative and quantitative** information like: – Countries likely affected – Proportion of profits that may be impacted – Effective tax rate comparisons

MSMEs (non-company entities) are **exempt** from disclosures under **paras 32C and 32D**

6 Summary

- Save now & Pay Later – DTL
- Pay Now & Save later – DTA
- Losses carried forward - DTA

Measurement
- Current Tax
  - Using the applicable tax rate and tax laws.
- Deferred Tax
  - Using the tax rates and tax laws that have been enacted or substantively enacted (only technical formalities pending) by the balance sheet date.
  - should not be discounted to their present value.

Disclosures:

Profit & Loss Account
- No specific requirement to disclose current tax and deferred tax.
- No requirement of reconciliation between accounting profit and the taxable income.

Balance Sheet
- Disclose under Non - Current liabilities
- Break-up of deferred tax assets and deferred tax liabilities into major components.
- Nature of evidence supporting the recognition of deferred tax assets (in case of unabsorbed depreciation or loss).

Assets and Liabilities representing

(i) Current Tax can be set off if legally enforceable right to sef off exists

(ii) Deferred Tax can be set off if legally enforceable right to set off assets against liabilities representing current tax exists ad the asset and liability relate to taxes on income under same law

AS – 4
Contingencies and Events Occurring after the Balance Sheet Date

1 Scope

AS - 4

- Contingencies
  - To the extent not covered by other Accounting Standards
- Events occurring after the Balance sheet date
  - Treatment and Disclosure

Note: Contingent liabilities are dealt with by AS – 29. Other contingencies like loss on bad debts are covered by AS 4.

2 Contingencies

Contingency

A condition or situation, whose ultimate outcome (gain or loss) will be known or determined only on the occurrence or non-occurrence, of one or more

2.1 Accounting Treatment of Contingent Losses:

The accounting treatment of a contingent loss is determined by the expected outcome of the contingency.

If it is likely that a contingency will result in a **loss** to the enterprise → It is prudent to **provide for that loss** in the financial statements.

The estimation of the amount of a contingent loss to be provided for in the financial statements, may be **based on judgement** made by management.

If there is **conflicting or insufficient evidence** for estimating the amount of a contingent loss → Disclosure is made of the **existence** and **nature** of the contingency.

The existence and amount of:
- guarantees,
- obligations arising from discounted bills of exchange and
- similar obligations undertaken by an enterprise

are generally disclosed in financial statements by way of note, even though the possibility that a loss to the enterprise will occur, is remote.

Example: ABC Ltd. has filed case against a debtor for a recovery of Rs. 25 Lakhs. According to the legal team, the chances of recovery is nil. Therefore, ABC Ltd. should make provision for doubtful debt.

2.2 Accounting Treatment of Contingent Gains:

Contingent gains are **not recognised** in financial statements as they may never be realised.

Exception:

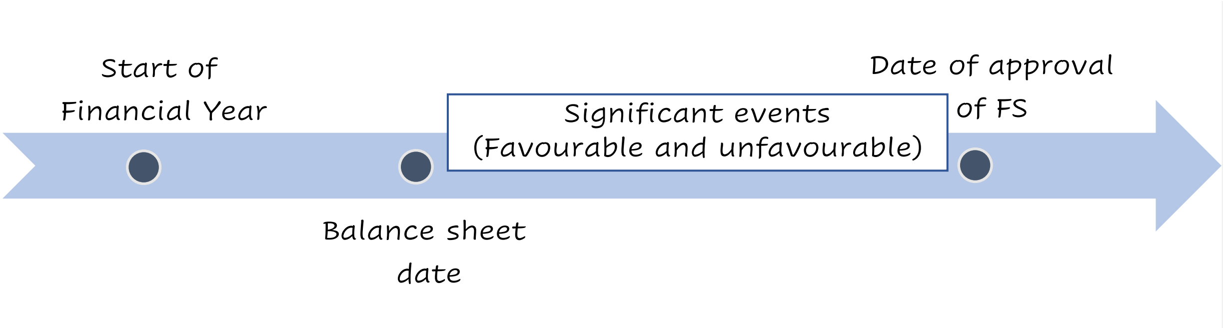
When the realisation of a gain is virtually certain → Such gain is not a contingency and **accounting for the gain is appropriate**.

Amount: The amount at which a contingency is stated in the financial statements is **based on the information** which is available **at the date on which the financial statements are approved.**

3 Events Occurring after the Balance Sheet Date

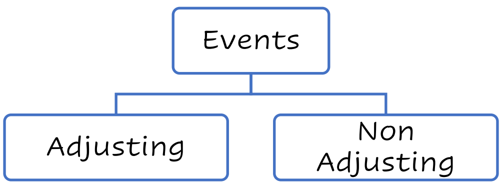
Events occurring after the balance sheet date are those significant events (both favourable and unfavourable) that occur between the balance sheet date and the date on which the financial statements are approved:

- by the Board of Directors – in the case of a company,
- by the corresponding approving authority – in the case of any other entity.



Example:
XYZ Ltd. closed its accounting year on 31.3.20X1 and the accounts for that period were considered and approved by the board of directors on 20.5.20X1. The company was engaged in laying pipeline for an oil company deep beneath the earth. While doing the boring work on 1.6.20X1 it met a rocky surface for which it was estimated that there would be an extra cost to the tune of Rs. 80 lakhs.

In this case, the events taking place between 01.4.20X1 to 20.5.20X1 are events occurring after the balance sheet date. As the event which was expected to push up cost, became evident after the date of approval of the accounts. So it is not an 'event occurring after the balance sheet date'



3.1 Adjusting Events:

Those events occurring after the balance sheet date which provide **further evidence of conditions** that existed **at the balance sheet date.** These provide additional **information**

materially affecting the determination of the amounts existing at the balance sheet date. These events are adjusted in the books of accounts.

Example:

Conditions existing at the Balance Sheet Date	Event occurring after the Balance Sheet Date
Provision created for doubtful debts	Bad debts due to insolvency of debtor
Provision created for legal claims against the company	Claim approved by the court
Theft before the Balance Sheet date	Theft detected before the accounts were approved by the Directors.

3.2 Non-Adjusting Events:

Those events occurring after the balance sheet date which are indicative of **conditions that arose after the balance sheet date**. Such events do not relate to conditions existing at the balance sheet date. These events are not adjusted in the books of accounts.

Example:
- Plant got damaged due to occurrence of fire/ flood/ earthquake.
- Payment of claims on account of Litigations or other legal proceedings commenced after Balance sheet date.
- Decline in market value of investments between the balance sheet date and the ate on which the financial statements are approved.

Significant non-adjusting event:

Events occurring after the balance sheet date which do not affect the figures stated in the financial statements would **not normally require disclosure in the financial statements**.

Exception: When these events are of such significance, they may require a **disclosure in the report of the approving authority** (report of the Board of Directors – in the case of a company) to enable users of financial statements to make proper evaluations and decisions.

Example:
- Material changes and
- Commitments affecting the financial position of the enterprise, etc.

Example:
Cheques bearing the date 31st March or before - the cheques received after 31st March do not represent any condition existing at the Balance sheet date. So, the **collection of cheques after balance sheet date is not an adjusting event**. Also, it does **not require any disclosure in the Directors' Report** because it does not represent any material change or commitments affecting financial position of the enterprise.

4 Special items

4.1 Dividend declared after balance sheet date:

There are events which, although take place after the balance sheet date, are sometimes reflected in the financial statements because of:
- statutory requirements or
- their special nature.

Example: If dividends are declared after the balance sheet date but before the financial statements are approved, the dividends are **not recognised as a liability at the balance sheet date** because no obligation exists at that time unless a statute requires otherwise. Such proposed dividends are **disclosed in the notes**.

4.2 Events indicating going concern assumption inappropriate:

Events occurring after the balance sheet date may indicate that the **enterprise ceases to be a going concern**. Events that may indicate a need to consider whether it is proper to use the fundamental accounting assumption of going concern in the preparation of the financial statements:

- Deterioration in operating results and financial position, or
- Unusual changes affecting the existence or foundation of the enterprise after the balance sheet date (e.g., destruction of a major production plant by a fire after the balance sheet date)

In case the going concern assumption is not valid → The financial statements are prepared on a liquidation basis.

Example:

An earthquake destroyed a major warehouse of ABC Ltd. on 20.5.20X2. The accounting year of the company ended on 31.3.20X2. The accounts were approved on 30.6.20X2. The loss from earthquake is estimated at Rs. 30 crores.

The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e., 31.3.20X2. So, loss occurred due to earthquake is not to be recognised in the financial year 20X1-20X2.

However, the earthquake has caused major destruction. So, the fundamental accounting assumption of going concern would have to be evaluated.

1. If it is valid: Disclose in the Board's report the fact and the amount of loss of Rs. 30 crores.

2. If it is invalid: Financial statements are prepared on a liquidation basis

5 Disclosures

The disclosure requirements are only for those contingencies and events which have material effect on the financial statements.

The following information should be disclosed for events occurring after the balance sheet date:

- The **nature** of the event
- An **estimate** of the financial effect, or a statement that such an estimate cannot be made.

6 Summary

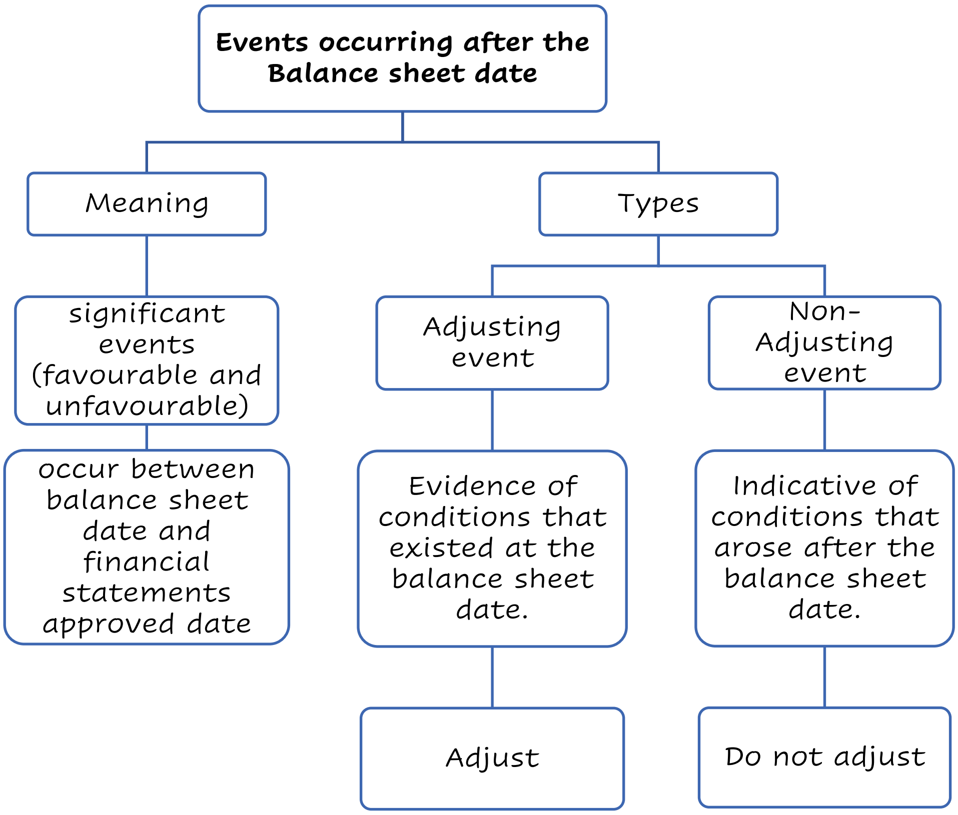
Contingency
(Condition / Situation)

If Ultimate outcome

- Gain
  - Generally: Not Recognised
  - Exception: Recognised when gain is virtually certain
- Loss
  - Prudent to recognise such losses based on the judgement.

Dividend declared after the Balance Sheet date:

- Not recognised as a liability
- Disclosed in the notes



Disclose:

- Nature of the event
- Estimate of the financial effect or statement that such an estimate cannot be made.

AS 5

Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

1 Introduction

1.1 Objective

All the enterprises prepare and present financial statements on uniform basis to enhance the **comparability**. For this AS 5 prescribes

- classification and
- disclosure

of certain items in the statement of profit and loss

1.2 Scope

AS 5 should be applied by an enterprise in

- presenting profit or loss from
  - ordinary activities,
  - extraordinary items, and
  - prior period items

  in the statement of profit and loss,
- accounting for changes in accounting estimates, and
- disclosure of changes in accounting policies.

AS 5 does not deal with **Tax implications** of

- extraordinary items,
- prior period items,
- changes in
  - accounting estimates

1.3 Definitions:

1.3.1 *Ordinary Activities*

Any activities which are undertaken by an enterprise as **part of its business** and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities.

1.3.2 *Extraordinary Items*

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

1.3.3 *Prior period items*

Income and expenses which arise in the current period because of error or omissions in the preparation of the financial statements of one or more prior periods.

1.3.4 *Accounting policies*

Specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

2 Net Profit or Loss for the Period

- All items of Income and Expense which are recognised in a period whether from ordinary activities or from extraordinary activities should be included in the determination of net profit or loss for the period

  Exception – Accounting Standard requires or permits otherwise.

- The net profit or loss for the period comprises:
  - profit or loss from ordinary activities and
  - extraordinary items.

  These should be disclosed on the face of the statement of profit and loss.

2.1 Profit or loss from ordinary activities

Profit or Loss from activities which are a part of its business and such related activities For Example, profit on sale of merchandise, loss on sale on inventory etc.

2.1.1 Ordinary activities of Exceptional Nature

Test for disclosure - If disclosure of an item of income and expense from ordinary activities is relevant to explain the performance of the enterprise for the period, the nature and amount should be **disclosed separately.**

Relevancy would be determined based on the impact on current profit or loss due to its

- Size
- Nature
- incidence

> The term' Exceptional nature' is not covered under AS 5 but the same has been used for better understanding of the students.

Circumstances where separate disclosure is necessary may include:

- Write-down of inventories to NRV and reversal of such write downs.
- Legislative/ statutory changes having retrospective application.
- Disposals of long-term investments or fixed assets.
- Litigation settlements

For Example: Selling of land by a real estate company is an ordinary activity whereas for a cement manufacturer, the same will be ordinary activity of exceptional nature requiring separate disclosure.

2.2 Extraordinary Items

Extraordinary items **should be disclosed** separately w.r.t nature and amount, in the statement of profit and loss as a part of net profit or loss for the period in a manner that its **impact on current profit and loss can be perceived.**

> The nature and amount of each extraordinary item should be disclosed separately in the statement of profit and .

Determination of an item to be extraordinary

- Depends on the nature of the event or transaction in relation to the business ordinarily carried on by the enterprise
- Doesn't depend on the frequency with which it is expected to occur

> Therefore, an event or transaction may be extraordinary for one enterprise but not so for another because of the differences between their respective ordinary activities.

Example of events or transaction that **generally** give rise to extraordinary item for most enterprise is:

- attachment of property of the enterprise, or
- an earthquake.

3 Prior Period Items

For an item to be classified as prior period item, it should satisfy **ALL** the three conditions mentioned below:

- It should be an error or omission
- It is rectified in the current accounting period.
- It is affecting the current Profit and loss account.

> **Prior Period Items**
>
> Errors & Omissions in Prior Periods => Income & Expense in Current Period

Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, or oversight.

- The nature and amount of prior period items should be **separately disclosed** in the statement of profit and loss such that the impact on the current profit or loss can be perceived.

For example: Purchases worth 1 crore were not recorded last year and are now rectified in the current financial year is a prior period item.

4 Changes in Accounting Estimate

4.1 Change – Reasons & Effect

Reasons to change accounting estimate:
- changes in circumstances on which the estimate was based, or
- new information, or
- more experience on subsequent developments.

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

- Current period (i.e. period of change), if the change affects the current period only,
- Current & Future Periods, if the change affects both.

For example, A change in the estimate of the number of bad debts affects only current period therefore it is recognised immediately, whereas a change in the estimated useful life of a depreciable affects the current period and subsequent period as well, thus change relating to current period is recognised in the current period and future effects if any, is recognised in future periods.

Accounting Estimate

It is the closest approximation of an account balance in the light of best available information at a given point of time.

4.2 Classification for change in accounting estimate

Classification in Statement of P&L for effect of change – same as estimate

4.3 Disclosure

Nature and amount of a change in accounting estimate should be disclosed if it has a material effect in

- current period, or
- subsequent periods,

should be disclosed.

If it is impracticable to quantify the amount, this fact should be disclosed.

5 Changes in Accounting Policies

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

Accounting policies can be **changed only**:

➤ when the adoption of a different accounting policy is required by statute; or

➤ for compliance with an Accounting Standard; or

➤ when it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.

Following are **not the changes** in accounting policies:

- The adoption of an accounting policy for events or transactions that differ in substance from, previously occurring events or transactions, for example *introduction of formal retirement gratuity scheme in place of ad hoc ex-gratia payments to employees.*
- The adoption of new accounting policy for events or transactions which did not occur previously or that were immaterial.

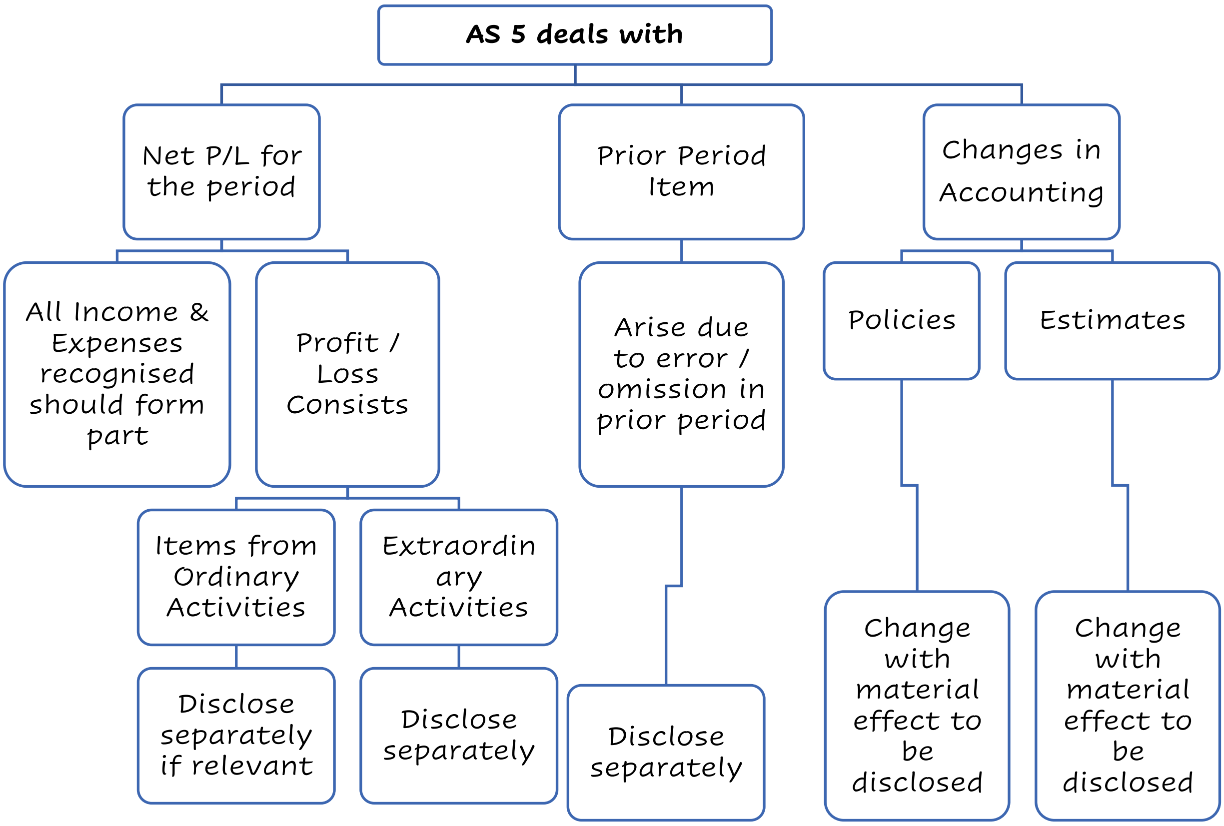
Disclosure

Any change in an accounting policy which has **material effect** should be **disclosed**. The impact in financial statements should be shown in the period in which such change is made.
When the effect of such change is not ascertainable, wholly or in part, the **fact should be indicated.**

> If a change has no material effect in the current accounting period but which is reasonably expected to have a material effect in the later accounting periods, the fact should be appropriately disclosed in the period in which such change is

6.

Summary



AS 17

Segment Reporting

1 Objective

The objective AS 17 is to establish principles for reporting financial information, about the different types of products and services an enterprise produces and the different geographical areas in which it operates.

Segment Reporting helps users of financial statements to:

- Better understand the **performance** of the enterprise
- Better assess the **risks and returns** of the enterprise
- Make more **informed judgements** about the enterprise

2 Scope and Applicability

Scope

- AS 17 should be applied, **fully and not selectively** in presenting **general purpose** financial statements.
- If a single financial report contains both consolidated financial statements and the separate financial statements of the parent, **segment information need be presented only on the basis of the consolidated financial statements**

Applicability

Companies	Non-Companies
•AS 17 is not mandatory for SMCs	•AS 17 is not mandatory for entities falling in Level I and II

3 Important Definitions

3.1 Reportable Segment

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

3.2 Business Segment

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

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

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

3.3 Geographical Segment

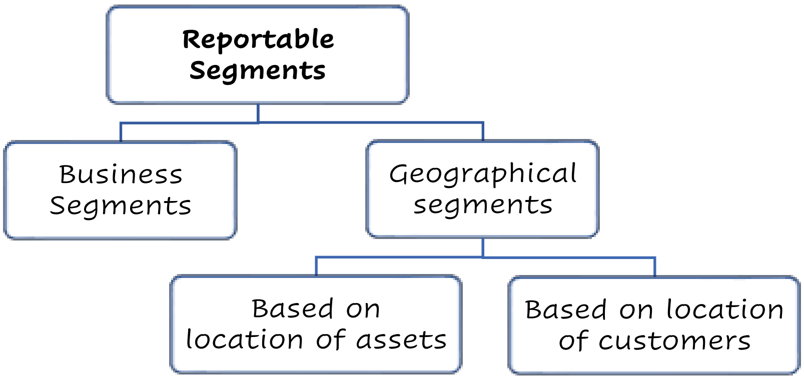
A distinguishable component of an enterprise that is engaged in providing **products or services within a particular economic environment** and that is subject to risks and returns that are different from those of components operating in other economic environments.

Factors to be considered in identifying geographical segments include:

- Similarity of economic and political conditions
- Relationships between operations in different geographical areas
- Proximity of operations.
- Special risks associated with operations in a particular area.
- Exchange control regulations and
- The underlying currency risks.

Identifying Reportable Segments as Primary Segment or Secondary Segment:

- A geographical segment may be a single country, a group of two or more countries, or a region within a country.
- Single geographical segment does not include operations in economic environments with significantly differing risks and returns.
- The risks and returns of an enterprise are influenced by the
  - geographical location of its operations and
  - location of its customers.



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

Internal organisation and management structure of an enterprise and its system of **internal financial reporting** to the board of directors and the chief executive officer should normally be the **basis for identifying** the predominant source and nature of risks and differing rates of return facing the enterprise

Risks & returns affected predominantly by the differences in the products and services?

- **Yes** → **Primary**-Business segment; **Secondary**-Geographic segment
- **No** → **Primary**-Geographical segment; **Secondary**-Business segment

4 Elements of Segment Reporting

1) Segment Revenue:

Aggregate of	Does not Include
Enterprise revenue that is **directly attributable** to a segment	Extraordinary items as defined in AS 5.
Enterprise revenue that can be **allocated** on a reasonable basis to a segment	Interest or dividend income**
Revenue from **transactions with other segments** of the enterprise	Gain on sales of investments or on extinguishment of debt##

*** Interest earned on advances or loans to other segments is also not included unless the operations of the segment are primarily of a financial nature.*

These will be included only if the operations of the segment are primarily of a financial nature.

2) Segment Expense:

Aggregate of	Does not Include
Operating activity expense directly attributable to the segment, and	Extraordinary items as defined in AS 5
Enterprise expense that can be allocated on a reasonable basis to the segment,	Interest expense**
Expense relating to transactions with other segments.	Losses on sales of investments or losses on extinguishment of debt#
	Income tax expense
	Expenses related to the enterprise as a whole@

**Interest incurred on advances or loans from other segments is also not included, unless the operations of the segment are primarily of a financial nature.

These are included in segment expense only if the operations of the segment are primarily of a financial nature.

@ Example - General administrative expenses, head-office expenses, and other expenses that arise at the enterprise level.

3) Segment Results

Segment Result = Segment Revenue − Segment Expense

4) Segment Assets :

Segment assets are those **operating assets** that are
- employed by a segment in its operating activities and
- either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.

Include	Does not Include
If segment result includes interest or dividend income, its segment assets include the related receivables, loans, investments, or other interest or dividend generating assets	Income tax assets;
	assets used for general enterprise or head-office purposes.

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

5) Segment Liabilities

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

Include	Does not Include
If interest expense is included in segment expense, its segment liabilities include the related interest-bearing liabilities.	income tax liabilities;
	borrowings and other liabilities that are incurred for financing rather than operating purposes.

Examples –

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

- **Assets and liabilities that relate jointly to two or more segments should be allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments.**

5 Criteria for Identifying Reportable Segments

Following are the criteria to satisfy to consider a business segment or a geographical segment is a reportable segment or not :

AS Para	Test	Criteria
Para 27a	Revenue Test	**Segment Revenue ≥ 10%** of Total Revenue of all segments
Para 27b	Result Test	**Segment Result ≥ 10%** of higher of combined result of all segments (profit or loss - absolute terms)
Para 27c	Assets Test	**Segment Assets ≥ 10%** of Total Assets of all segments
Para 28	Management choice	Business / geographical segment is not a reportable segment as above criteria not met Management may designate (despite its size)
Para 29	75% Test	Reportable segments' total external revenue < 75% of total enterprise revenue Additional segments identified as reportable segments (despite not meeting 10% criteria)

Note:

- Previous year's reportable segment to continue in current year even though current year 10% thresholds not satisfied.
- If inconsistent, previous year figures to be regrouped to fall in line with current year.

6 Treatment of Interest

- The interest expense relating to overdrafts and other operating liabilities 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.
- In case interest is included as a part of the cost of inventories as per AS 16, read with AS 2 (Revised), and those inventories are part of segment assets of a particular segment, such interest should be considered as a segment expense.

7 Primary and Secondary Segment Reporting Formats (Disclosure Requirements)

a) Primary Reporting Format

An enterprise should disclose the following for each reportable segment identified as primary segment:

i. Segment revenue, classified into segment revenue from sales to external customers and segment revenue from transactions with other segments;
ii. Segment result
iii. Total carrying amount of segment assets;
iv. Total amount of segment liabilities;
v. Total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets);
vi. Total amount of expense included in the segment result for depreciation and amortisation in respect of segment assets for the period; and
vii. Total amount of significant non-cash expenses, other than depreciation and amortisation in respect of segment assets, that were included in segment expense and, therefore, deducted in measuring segment result.

b) Secondary Segment Information

If primary format is business segment, it should also report the following information:

- **Segment revenue from external customers** by **geographical** area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers **is 10 per cent or more** of enterprise revenue;

- The total carrying amount of **segment assets by geographical location** of assets, for each geographical segment whose segment assets are **10 per cent or more** of the total assets of all geographical segments; and

- The total cost incurred during the period to **acquire segment assets** that are expected to be **used during more than one period** (tangible and intangible fixed assets) by geographical location of assets, for each geographical segment whose segment asset are **10 per cent or more** of the total assets of all segments.

If primary format is geographical segments (whether based on location of assets or location of customers), enterprise should also report the following:

Enterprise should report the following segment information for each business segment whose **revenue from sales to external customers** is **10 per cent or more** of enterprise revenue or whose **segment assets** are **10 per cent or more** of the total assets of all business segments:

- **Segment revenue** from external customers;
- The total carrying amount of **segment assets**; and
- The total cost incurred during the period to **acquire segment assets** that are expected to be used during more than one period (tangible and intangible fixed assets).

If primary format of an enterprise for reporting segment information is geographical segments that are based on location of assets, and if the location of its customers is different from the location of its assets,

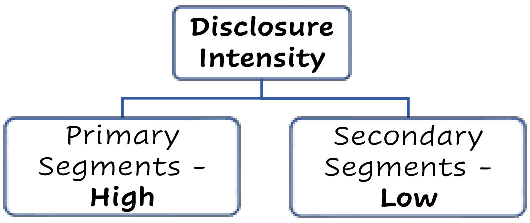
Enterprise should also **report** revenue from sales to external customers for each customer-based geographical segment whose revenue from sales to external customers is **10 per cent or more** of enterprise revenue.

If primary format of an enterprise for reporting segment information is geographical segments that are based on location of customers, and if the assets of the enterprise are located in different geographical areas from its customers,

Enterprise should also **report** the following segment information for each asset-based geographical segment whose revenue from sales to external customers or segment assets are **10 per cent or more** of total enterprise amounts:

- The total carrying amount of segment assets by geographical location of the assets
- The total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by location of the assets

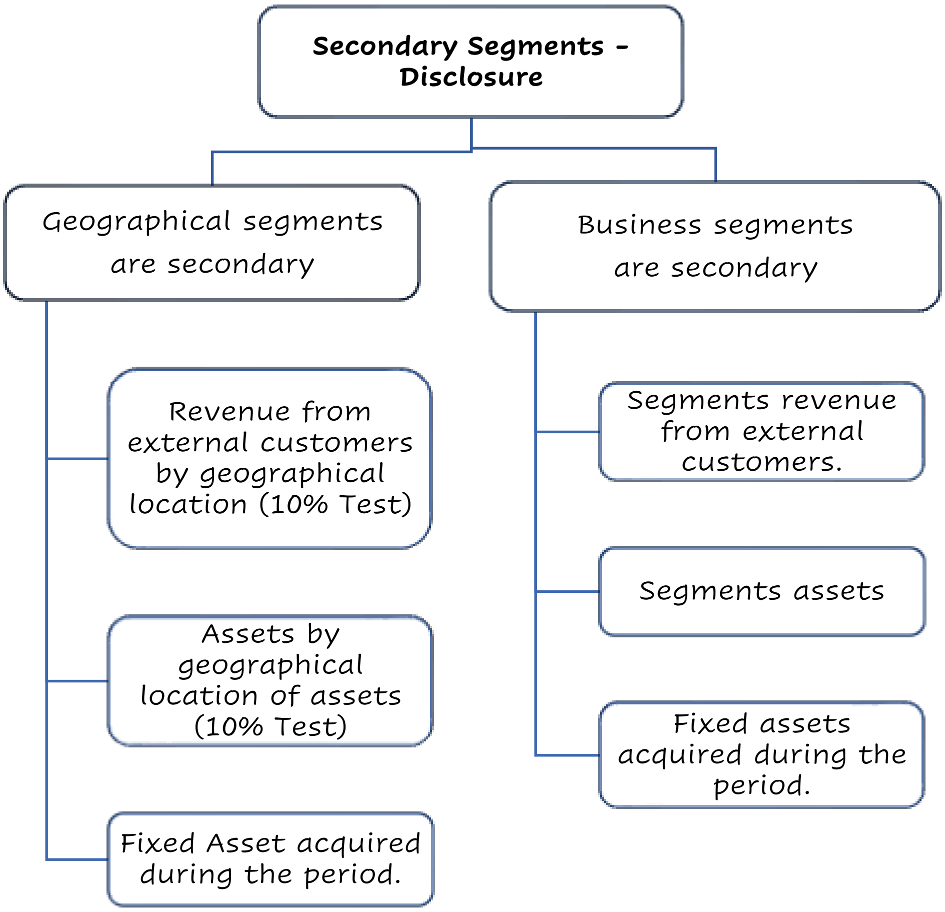
8 Disclosure Requirement



- Primary Segment disclosures (for each primary segment)
  a) Segment Revenue (External + Internal segment)
  b) Segment Result
  c) Segment Assets.
  d) Segment Liabilities
  e) Capital expense incurred during the period

f) Depreciation charge for the period
g) Other non-cash expenses during the period. Disclosure required for secondary segments.

- Secondary Segment Disclosures.



9 Other Disclosures

- In measuring and reporting segment revenue from transactions with other segments, inter-segment transfers should be **measured on the basis that the enterprise actually used** to price those transfers.
- The **basis of pricing inter-segment transfers** and any change therein should be disclosed in the financial statements
- An enterprise should indicate **the types of products and services** included in each reported business segment and **indicate the composition** of each reported geographical segment, both primary and secondary, if not otherwise disclosed in the financial statements.

Changes **in accounting policies** adopted for segment reporting that have a **material effect on segment information** should be disclosed. Such disclosure should include a description of the nature of the change, and the financial effect of the change if it is reasonably determinable.

Some changes in accounting policies may relate specifically to segment reporting like:
• changes in identification of segments; and
• changes in the basis for allocating revenues and expenses to segments.

Such changes can have **a significant impact on the segment information** reported but will **not change** aggregate financial information reported for the enterprise. To enable users to understand the impact of such changes, this Standard requires the disclosure of the **nature of the change and the financial effects** of the change, if reasonably determinable.

9 Summary

Test	Criteria
Revenue Test	**Segment Revenue ≥ 10%** of Total Revenue of all segments
Result Test	**Segment Result ≥ 10%** of higher of combined result of all segments (profit or loss - absolute terms)
Assets Test	**Segment Assets ≥ 10%** of Total Assets of all segments
Management choice	Business / geographical segment is not a reportable segment as above criteria not met Management may designate (despite its size)
75% Test	Reportable segments' total external revenue < 75% of total enterprise revenue Additional segments identified as reportable segments (despite not meeting 10% criteria)

AS 18

Related Party Disclosures

1 Introduction

1.1 Objective

The objective of AS 18 is to establish requirements for disclosure of:

(a) related party relationships; and

(b) transactions between a reporting enterprise and its related parties.

No disclosure is required in CFS in respect of intra group transactions.

1.2 Scope

The requirements of AS 18 applies to financial statements of each reporting enterprise and to Consolidated Financial Statements (CFS) presented by holding company.

Not in Scope

- Related party relationships with other state-controlled enterprises and transactions with such enterprises in the financial statements of state-controlled enterprises.
- Circumstances where disclosures would **conflict** with the reporting **enterprise's duties of confidentiality** as per statute or by any regulator or similar competent authority.

1.3 Definitions:

1.3.1 *Related party*

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

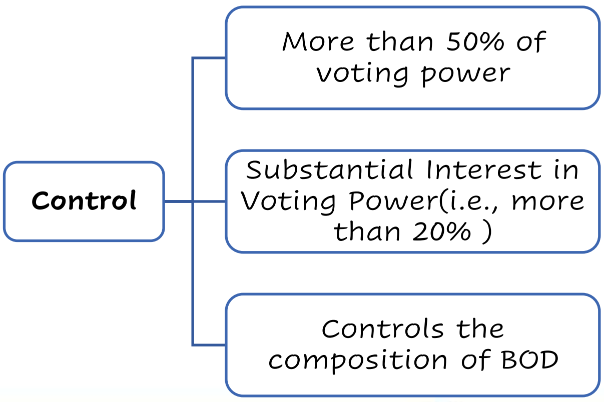
1.3.2 *Related party transaction*

A transfer of resources or obligations **between related parties**, regardless of whether a price is charged.

1.3.3 *Control*

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

An enterprise/individual is considered to have substantial interest in another enterprise if that enterprise or individual **owns 20% or more interest** in the voting power of the other enterprise.



1.3.4 *Significant influence*

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

1.3.5 *An Associate*

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

1.3.6 *Key management personnel*

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

1.3.7 *Relative*

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

2 Types of Related Party Relationships

Related party relationships can be categorised into two parts:

Related Party Relationships
- In Relation to a person
- In Relation to an entity

2.1 Related party relationships in relation to a person.

It includes two things:

1. A person or his relative or both is related to a reporting entity if:
   a) He has **control** over the reporting entity.
   b) Has **significant influence** over the reporting entity

   through owning interest in voting power.

   For Examples:
   i) Mr XYZ holds 51% share capital of ABC Ltd. As Mr XYZ controls ABC Ltd, he is a related party.
   ii) Mr ABC holds 25% interest in voting power of PQR Ltd. As Mr ABC holds more than 20% voting power, he is related party of PQR Ltd.

   Voting power means, with respect to any person, the ability to cast vote in any resolution through ownership of securities which contains voting rights. (For example: Equity Shares)

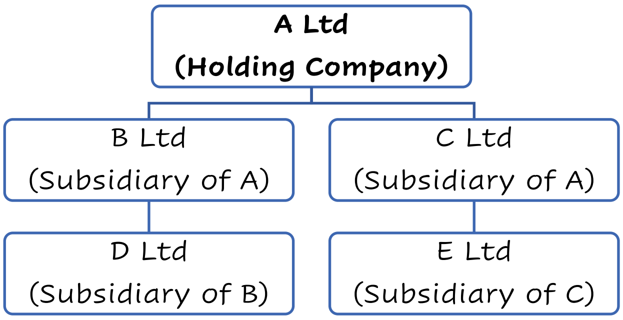
2. A person or his relative is a member of the **Key management personnel** (KMP) of the reporting entity.
   For Example: Mrs H is a director of S Ltd. Being a member of KMP of S Ltd, she along with her relatives are related to S Ltd.

2.2 Related party relationships in relation to another entity.

1. Enterprise that directly or indirectly through one or more intermediaries,
   a. **Control**, or
   b. **Are controlled** by, or
   c. are **under common control**

   with the reporting enterprise (this includes holding, subsidiaries and fellow subsidiary companies).

For Example:



Here, A Ltd is the Holding Company of B and C Ltd and B & C Ltd is the holding company of D and E Ltd respectively.
A Ltd control B &C Ltd directly, D and E Ltd are controlled by B and C Ltd directly and indirectly by A Ltd (through subsidiaries), and both D/E and B/C (Fellow subsidiaries) are under common control of A Ltd. Hence every member is related to each other in the group.

2. One entity is **Associate or Joint Venture** of the reporting enterprise.
   For Example: A holds 25% voting power in B Ltd, then B Ltd is associate of A Ltd. Hence A & B are related to each other.

   Suppose, A and B Ltd forms joint venture AB Ltd. Here A is related to AB, B is related to AB Ltd **but** A and B Ltd (Co – Venturers) are **Not** related to each other.

3. Enterprises over which any person who has **direct control or who is KMP** (described in Type 1 Relation above) can exercise significant influence.
   For Example: Mr P has direct control in R Ltd and he is also an Executive Director of Q Ltd. Since, Mr P can exercise significant influence in both R and Q Ltd, R and Q Ltd are related parties.

Deemed not to be related parties:

1. Two companies **having common director** unless the director can influence the decisions of both the companies.
2. A single customer/supplier with an enterprise **deal in large volume** of transactions, then such enterprise is not related with that customer/supplier just because of **economic dependence**. For example: 75% of the revenue of A Ltd comes from the sales made to one person Mrs B. Just because A Ltd is heavily dependent on Mrs B for its revenue, Mrs B and A Ltd cannot be considered as related parties.
3. Government department, agencies, trade unions, public utilities, providers of finance cannot be related to the enterprise by **virtue of their normal dealings** in the ordinary course of business.

3 Requirement for disclosure

Related party transactions are a normal part of the business. Without related party disclosures, it is assumed that the transactions with related parties would have been made at arm's length prices. But that is not the case, transactions with related party may not be affected in the same way with the unrelated one.
Just being in related party relationship without even making any transactions could have effect on financial results of the enterprise.

4 Exemption from Related Party Disclosure in Certain Situations

- Conflict with the reporting enterprise's duties of confidentiality.
- Consolidated financial statements.
- State controlled enterprise.

4 Related Party Disclosures

- **Disclosure (with or without transactions during the period)**
  Name of the related party and nature of the related party relationship where control exists should be disclosed **irrespective** of whether there have been transactions between the related parties.

- **Disclosure for transactions during the period**
  If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

> It is important to disclose related party relationships even when there is no transaction during the year.

Disclosures
- Transacting related party name.
- Relationship Description
- Nature of transaction
- Volume of the related party transactions.
- Any other relevant elements to understand the FS
- Outstandings & provision for doubtful debts as at BS date against related parties
- Amount written off / back during the period

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

> Remuneration paid to KMP should be considered as related party transaction. Remuneration paid to non-executive director is not considered as related party transaction as non-executive director is not KMP just because he is director.

5 Summary

Related parties - Parties are related if, at **any time during the reporting period** one party can

- control the other party or
- exercise significant influence over the other party

in making financial and/or operating decisions.

Related Party Relationships

- Enterprises that are directly or indirectly controlled by the reporting enterprise
- Associates and Joint Venture of the entity.
- Individuals who have control or significant influence & their relatives.
- KMP and relatives of such personnel.
- Enterprise over which any person described in (c) or (d) is able to exercise significant influence.

AS 20

Earnings per Share

1. Introduction

1.1. Objective

The objective of this Standard is to prescribe principles for the

- determination of EPS and
- presentation of EPS

which will improve comparison of performance among

  - different enterprises for the same period and
  - different accounting periods for the same enterprise.

1.2. Scope

- AS 20 is mandatory for **all entities.**
  - Disclosure of Diluted EPS is not mandatory (but encouraged to disclose) for Small and Medium Sized Companies
  - Micro, Small and Medium Sized Enterprises (Level IV, level III or Level II non-company entities) may not apply AS 20.
- In Consolidated Financial Statements, the information required by AS 20 should be presented on the basis of consolidated information.

1.3. Definitions:

Potential Equity share

A potential equity share is a financial instrument or other contract that **entitles** or **may entitle**, its holder to **equity shares.**

Examples of potential equity shares:

- Debentures or preference shares that can be converted to equity shares.
- Share warrants
- Options including Employees stock option plan.
- Shares which will be issued upon satisfaction of certain conditions resulting from contractual obligations.

Note: A partly paid-up share where the holder is not entitled to dividends is treated as a potential equity share for the purposes of computing Diluted EPS

Share warrants or options

Share warrants is a financial instrument that give the holder the right to acquire equity shares.

> Any document issued by the company under common seal, stating that the bearer is entitled to the shares specified therein is a share warrant.

Fair Value

Amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

2. Basic Earnings per share

Basic Earnings per share is calculated as:

$$\frac{\text{Earnings (Net profit / loss) available for Equity Shareholder (EAESH)}}{\text{Weighted number of equity shares outstanding during the period}}$$

EAESH:

- All items of income or expense which are incurred during the period including tax expense are included in determination of Profit or loss for the period.

- EAESH = Net profit after tax - preference dividend
(Note: preference dividend is added to the net loss for the period to compute the EAESH)

The amount of preference dividend on cumulative shares **will not** include dividend which pertains to prior periods paid during current year.

Treatment of Dividends on Preference shares

Nature	Whether declared	Treatment for EPS
Cumulative	Irrelevant	Deduct the amount of dividend for each year. Declaration is not relevant
Non-Cumulative	Yes	Deduct from profits for the financial year
Non-Cumulative	No	No deduction

In exam questions if preference shares are given, assume that dividends have been declared.

Different classes of equity shares - net profit or loss for the period is apportioned over the different classes of shares in accordance with their dividend rights.

Weighted number of Equity shares outstanding during the period:

- The weighted number of equity shares outstanding during the period is
  - the number of shares outstanding at the beginning of the period adjusted by
  - the number of equity shares bought back or issued during the period
  - multiplied by the time weighting factor.

$$\text{Time weighing factor} = \frac{\text{Number of days shares are outstanding}}{\text{No. of days in the period}}$$

In most cases, shares are included in the weighted average number of shares from the date the consideration is receivable, for example:

a) equity shares issued in exchange for cash are included **when cash is receivable.**
b) equity shares issued as a result of the conversion of a debt instrument to equity shares are included as of the **date of conversion.**
c) equity shares issued in lieu of interest or principal on other financial instruments are included as of the **date interest ceases to accrue.**
d) equity shares issued in exchange for the settlement of a liability of the enterprise are included as of the **date the settlement becomes effective.**
e) equity shares issued as consideration for the acquisition of an asset other than cash are included as of the **date on which the acquisition is recognised**; and
f) equity shares issued for the rendering of services to the enterprise are included as the **services are rendered.**
g) Equity shares issued as consideration in an amalgamation **in the nature of purchase** are included as on the **date of acquisition**.
h) Equity shares issued as consideration in an amalgamation **in the nature of merger** are included from the **beginning of the reporting period**.

Timing of inclusion of equity shares is determined by the specific terms and conditions attaching to their issue.

i) **Partly paid up shares** are treated as fraction of an equity share to the extent they are **entitled to participate in dividend** in respect to fully paid up equity shares.
j) **Contingently issuable shares** are issuable upon satisfaction of certain conditions are included in computation of basic earning from the date when all the **necessary conditions are satisfied.**

Bonus issue/ Share split:

a. In case of bonus issue or share split, equity shares are issued to existing holders for no additional consideration. Thus, the number of shares outstanding is increased **without increase in resources.**
b. In such case, the number of shares outstanding before the event(bonus/split) is adjusted for proportionate change in number of shares as if the event **had occurred at the beginning of the reporting period.**
c. Thus, along with adjustment in current year, it will also impact the calculation of EPS of **last year retrospectively**.

Right issue:

- In right issue, exercise price is usually less than the fair value of the shares i.e. it includes a bonus element.
- The number of shares outstanding prior to the issue is **multiplied by the adjustment factor:**

$$\frac{\text{Fair value per share prior to exercise of right}}{\text{Theoretical ex-right price (fair value) per share}}$$

Theoretical ex-right Price (TERP) is calculated as follows:

$$\frac{\text{Fair value of shares prior to exercise of right + proceeds from right issue}}{\text{No. of shares outstanding prior to exercise of right + No. of right shares}}$$

3. Diluted Earnings Per Share

Diluted Earnings per share is calculated as follows:

$$\frac{\text{Diluted EAESH}}{\text{Weighted number of Outstanding equity shares + Potential Equity shares}}$$

Diluted EAESH:

For the purpose of calculating diluted earnings per share, the amount of net profit or loss for the period attributable to equity shareholders (EAESH) should be adjusted by the following, **after considering any attributable tax expense** for the period:

a) any **dividends** on dilutive potential equity shares which have been deducted in arriving at EAESH. Example: Preference Dividend
b) **Interest** recognised in the period for dilutive potential equity shares

c) **Any other changes** in income or expense that would result from the conversion of dilutive potential equity shares.

After the potential equity shares are converted into equity shares, the dividends, interest and other expenses or income associated with those potential equity shares will **no longer be incurred (or earned)**. Hence, these are adjusted from EAESH.

Examples of Potential Equity Shares:

(a) convertible debentures or preference shares,
(b) share warrants;
(c) options including ESOPs; and
(d) contingently issuable shares against contractual arrangements

Weighted number of Equity shares outstanding:

- For calculating Diluted EPS, weighted number of equity shares outstanding (same as basic EPS) and weighted number of equity shares which **would be issued on the conversion** of all the dilutive potential equity shares into equity shares are used in denominator.
- Dilutive potential equity shares should be **deemed to have been converted** into equity shares at the **beginning of the period** or, if issued later, **the date of the issue** of the potential equity shares.
- Contingently issuable shares are included in computation of Diluted EPS from the day conditions are met, if not met then from the beginning of the reporting period.

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

Note: Students are requested to refer Illustrations for better understanding of Basic and Diluted EPS computation.

Share warrants:

Options and other share purchase arrangements are dilutive when they would result in the issue of equity shares for less than fair value. The amount of the dilution is fair value less the issue price. Therefore, in order to calculate diluted earnings per share, each such arrangement is treated as consisting of:

a. a contract to issue a certain number of equity shares at their average fair value during the period. The shares to be so issued are fairly priced and are assumed to be neither dilutive nor anti-dilutive. Hence, they are ignored in computation.

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

Dilutive Potential equity shares:

i. Potential equity shares should be treated as **dilutive** when, and only when, their conversion to equity shares would **decrease net profit per share** from continuing ordinary operations.

ii. Potential equity shares are **anti-dilutive** when their conversion to equity shares would **increase earnings per share** from continuing ordinary activities or decrease loss per share from continuing ordinary activities The effects of anti- dilutive potential equity shares are ignored in calculating diluted earnings per share.

iii. Potential equity shares are weighted for the period **they were outstanding**. Potential equity shares that have been converted into equity shares during the reporting period are included in the calculation of diluted earnings per share **from the beginning** of the period to the **date of conversion.**

Potential Equity Shares

- Dilutive, if decreases Earnings per share (from continuing ordinary operations)
- Anti-Dilutive, if increases earnings per share.

The net profit from continuing ordinary activities is the net profit from ordinary activities (as defined in AS 5) after deducting preference dividends and any attributable tax thereto and after excluding items relating to discontinued operations3.

4. Restatement

- If the number of equity or potential equity shares outstanding
    - increases as a result of
        - bonus issue or
        - share split or
    - decreases as a result of a reverse share split (consolidation of shares),

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

- If these changes occur after the balance sheet date but before the date on which the financial statements are approved by the board of directors, the per share **calculations** for those financial statements and any prior period financial statements presented should be **based on the new number of shares**. When per share calculations reflect such changes in the number of shares, **that fact should be disclosed.**

5. Presentation and Disclosure

An enterprise should present basic and diluted earnings per share (**even if amount is in negative**) on the **face of statement of profit and loss** for each class of equity share with **equal prominence**.

An enterprise should disclose the following:

a) where the statement of profit and loss includes extraordinary items (as defined in AS 5), the enterprise should disclose
    - **basic EPS and**
    - **diluted EPS**

   computed on the basis of earnings **excluding extraordinary items** (net of tax expense).

b) the amounts used as the numerators (EASH & DEASH) in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss for the period.

c) the weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other; and

d) the nominal value of shares along with the earnings per share figures.

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6. Summary

Basic Earnings per Share (EAESH / WAES)

EAESH= Net profit after tax less preference dividend

WAES = Weighted average no of equity shares outstanding during the period

Bonus/ Share split

- No additional consideration / resources.
- No of equity shares o/s adjusted for from the beginning of the reporting period.
- Impact on calculation of last year EPS retrospectively.

Right issue

- Exercise price < the FV of share.
- No of equity share o/s prior to issue multiplied by adjustment factor.
- Adjustment Factor is value per share divided by theoretical ex-right value per share.

Diluted Earnings per Share

Numerator= EAESH + Preferece dividend+ interest(tax adjusted) + other changes in income/expense

Denominator=Weighted average no of equity shares outstanding during the period + dilutive potential equity shares

Dilutive potential equity share would be deemed to have been converted into equity shares at the beginning of the period, if issued later, from the date of issue of potential equity shares.

- An enterprise should present basic and diluted earnings per share (**even if amount is in negative**) on the **face of statement of profit and loss** for each class of equity share with **equal prominence**.
- If the number of equity or potential equity shares outstanding increases as a result of a bonus issue or share split or decreases as a result of a reverse share split, the calculation of basic and diluted earnings per share should be **adjusted for all the periods presented.**

AS 24
Discontinuing Operations

1. Introduction

1.1. Objective

The Objective of this standard is to establish principles for:

- Reporting information about discontinuing operations.
- Enhancing the users of financial statements to make projections of an enterprise cashflows by separating information about discontinuing operations from information about continuing operation.

1.2. Scope

This standard applies to all discontinuing operations of an enterprise.

Also, the requirements related to cash flow statement contained in this standard is applicable only when an enterprise prepares and presents one.

2. Discontinuing Operations

A discontinuing operation is a component of an enterprise:

1. that the enterprise in **a single coordinated plan** is

   a) Disposing of substantially in **its entirety** such as by

      (ii) selling the component in a single transaction or
      (iii) demerger
      (iv) spin off ownership of component to enterprise's shareholders.

   b) Disposing of **piecemeal**, by selling component's assets and liabilities individually or
   c) Terminating through **abandonment** (to give up) and

2. that represent a **separate** major line of business or geographical area of operations. (Like business segment and geographical segments as described in AS 17)

3. that can be **distinguished** operationally and for financial reporting purposes.

A component can be distinguished operationally and for financial purposes if

- assets or liabilities,
- revenue, and
- majority of operating expenses

can be directly attributed to that component.

For Example:

- Citi announced in April 2021 that it would **exit its consumer/retail banking operations** in 13 countries, **including India**.

Infrequent event –

Discontinuing operations are **not frequently occurring events**, but **all infrequently occurring events** do **not necessarily qualify** as **discontinuing operations**.

Infrequently occurring events that **do not qualify** as discontinuing operations may still result in **items of income or expense** that require **separate disclosure** as per **AS 5 – Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies**.

Abandoned operation - An enterprise may terminate an operation by abandonment without substantial sales of assets. **An abandoned operation would be a discontinuing operation** if it satisfies the criteria in the definition.

Example of activities that do not necessarily satisfy criterion (1) of the definition:

1. Gradual phasing out of a product or class of service. For example, Suryoday small finance bank has discontinued its ATM services due to viability issues.
2. Discontinuing several products within an ongoing line of business. For example, when Steve jobs returned to apple in 1997, he reduced 70% of the apple products to emphasise on quality and innovation on only a few products.
3. Shifting of production facility from one location to another. For example, Israel based Watergen, that makes water from air is shifting its manufacturing facilities from US and China to India.
4. Closing of a facility to achieve productivity improvements. For Example, closure of one non profitable branch out of many branches of a franchise.

> Discontinuing operation doesn't affect the enterprises' ability to continue as a going concern.

3. Initial Disclosure Event

The initial disclosure event is the disclosure of discontinuing operation if any of the following occurs earlier:

1. Enterprise has entered into binding sale agreement for substantially all the assets of the component being discontinued.
2. The enterprise's board of directors has both
   (i) **approved a detail**, formal plan for discontinuance and
   (ii) have **made an announcement** for the same to those affected by it (For e.g., lenders, stock exchanges, creditors trade unions etc.)

A detailed plan normally answers the following questions:

a) Which assets need to be disposed of?
b) Which method of disposal will be used – piecemeal or in entirety?
c) Timeline for completion of disposal?
d) Which geographic locations will be affected by disposal?
e) Number of employees who will be terminated from their service due to disposal?
f) How much scrap/salvage will be realised from discontinuance?

4. Recognition and Measurement

An enterprise should apply the principles of recognition and measurement that are specified in other AS to deciding

(i) when to recognise and measure and
(ii) how to recognise and measure

the changes in assets and liabilities and the revenue, expenses, gains, losses, and cashflows relating to discontinuing operations.

5. Presentation and disclosure

Following information need to be disclosed in the financial statements of the enterprise related to discontinuing operations, initially in the period in which disclosure events occurs:

1. **Description** of the discontinuing operation.

2. The **business or geographical segment** which is reported as per AS 17.
3. The **date and nature** of initial disclosure event.
4. The **period** in which discontinuance is expected to be completed.
5. The **carrying amount** of assets and liabilities of the component being discontinued.
6. The amount of **revenue and expenses** from ordinary activities of discontinuing operation during current reporting period.
7. The amount of **pre-tax loss or profit** from ordinary activities pertaining to discontinuing operation.
8. The amount of **net cash flows** attributable from operating, investing, & financing activities of discontinuing operation during the current reporting period.

> There should be separate disclosure for each discontinuing operation.

Disclosures for binding agreements for sale attributable to discontinuing operation:

i) for any gain or loss that is recognised on the disposal,
- the amount of the pre-tax gain or loss and
- income tax expense relating to the gain or loss; and

ii) the net selling price or range of prices net of disposal costs of those net assets included in binding sale agreements,
iii) the expected timing of receipt of those cash flows and the carrying amount of those net assets on the balance sheet date.

> All the disclosures other than pre-tax profit or loss from discontinuing operation should be shown in **the notes to the financial statements**. (Amount pertaining to pre-tax profit or loss should be shown **in the face of** the statement of P&L.

Completion of Discontinuance
- The disclosures should continue in the financial statements for
  - periods up to where discontinuance is completed and
  - period in which discontinuance is completed.

> Discontinuance is completed when the plan is **substantially completed** whether payment from buyer is received or not.

Withdrawal of plan
- If an enterprise abandons or withdraws from a plan that was previously reported as a discontinuing operation, that **fact, reasons** therefore and its effect should be disclosed.

Ways of discontinuance
- 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. For example, salary of the continuing staff of a discontinuing operation.

Comparative Information
- Comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event **should be restated to segregate** assets, liabilities, revenue, expenses, and cash flows of continuing and discontinuing operations in a manner like that mentioned above.

Interim Financial Reports

Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25. Disclosure should include:

- significant activities or events since the end of the most recent annual reporting period
- significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

6. Summary

➢ **A discontinuance of one product or service does not end the going concern assumption.**

➢ Once the initial disclosure requirement is met, enterprise needs to start disclosing various information related to discontinuing operation in the Notes to Financial statements till the period in which the whole process is completed.

Component of Enterprise

- Single Plan (EPT)
  - Disposing in Entirely
  - Piecemeal Distribution
  - Termination by giving up
- Separate Major Line of business or geopraphical area of operations
- Can be distinguished operationally and for financial reporting purposes

➢ Income, expense, assets, liabilities and cashflows of an enterprise should be separately disclosed for both continuing and discontinuing operation.

AS 25
Interim Financial Reporting

1. Introduction

1.1 Objective

- To prescribe the minimum content of an interim financial report and
- To prescribe the principles for recognition and measurement in complete or condensed financial statements for an interim period.

1.2 Scope

- This Standard applies if an entity is required or elects to publish an interim financial report in accordance with Indian Accounting Standards.

2. Key Aspects

2.1 Interim Financial Statement

Interim period is a financial reporting period shorter than a full financial year.

Interim financial report means a financial report containing either

- a complete set of financial statements or
- a set of condensed financial statements for an interim period.

2.2 Minimum components of Interim Financial Statements

An interim financial report should include, at a minimum, the following components

a. Condensed **Balance Sheet**
b. a condensed statement of **profit and loss;**
c. a condensed statement of **cash flows**; and
d. selected **explanatory notes**.

2.3 Form and Content of Interim Financial Statements

Complete Set of Financial Statements	Requirements as applicable to annual complete set of financial statements
Condensed Set of Financial Statement	**Minimum –** Each of the **headings and sub totals** that were included in recent annual financial statements and explanatory notes. **Additional line items** or notes should be included if their omission would make the condensed interim financial statements misleading
Statement of P&L	Basic and diluted EPS as required by AS 20

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2.4 Periods for which interim financial statements are required to be presented

Interim reports shall include interim financial statements (condensed or complete) for periods as follows:

Statement	**Current period**	**Comparative period**
Balance Sheet	End of current interim period	Comparative balance sheet at the end of preceding FY
Profit and Loss	Current Interim Period and cumulatively for the year to date	Cumulative for Year to Date Comparative for preceding period [YTD & Interim]
Statement of Cash Flows	Year to Date	Comparative for Previous YTD

Example

Statement	Current Period	Comparative Period
Balance Sheet as at	**30-Sep-20X2**	**31-Mar-20X2** (end of preceding FY)
Profit & Loss – Interim	**01-Jul-20X2 to 30-Sep-20X2**	**01-Jul-20X1 to 30-Sep-20X1**
Profit & Loss – (YTD)	**01-Apr-20X2 to 30-Sep-20X2**	**01-Apr-20X1 to 30-Sep-20X1**
Cash Flow Statement (YTD)	**01-Apr-20X2 to 30-Sep-20X2**	**01-Apr-20X1 to 30-Sep-20X1**

2.5 Important aspects

Topic	Key Principle	Example / Explanation
Materiality	**Materiality** assessed in relation to **interim period financial data**.	E.g., ₹5 lakh error may be material for a quarter but not for the full year.
Recognition & Measurement	• Apply same **accounting policies** in **interim** and **annual financial statements**, except changes to be reflected in **next annual statements**. • Measurements are made on a **year-to-date basis** and cumulative adjustment is made in current interim period • Annual reporting is not affected because of interim reporting • Income tax is reported based on weighted average tax rate applicable for the relevant year.	E.g., WDV Depreciation charged considering annual computation. Taxes are updated based on new information each quarter
Revenues received seasonally / cyclically / occasionally	Such revenues should **not be anticipated or deferred** at interim dates if not appropriate at year-end.	E.g., Dividend income, royalties, government grants.
Costs incurred unevenly	Such costs should be **anticipated or deferred** only if it is appropriate to do so at year-end.	E.g., Insurance premium paid upfront → deferred; advertising campaign → expensed as incurred.
Use of estimates	Interim reporting requires **greater use of estimates** than annual reports, but must remain **reliable** and **relevant**.	E.g., Provision for doubtful debts based on trends until September.
Restatement of previously reported interim periods	**Single accounting policy** applies to a class of transactions throughout the year. If policy changes, apply it **retrospectively from beginning of financial year**.	E.g., Change from FIFO to Weighted Average in inventory valuation → restate Q1 & Q2 figures.
Deferral of costs	If a cost does not meet the definition of an asset at the end of reporting period, it is not deferred	Advertisement expense is charged in the interim period in which it is incurred.

3. Selected Explanatory Notes

a) A statement that the same **accounting policies** and **methods of computation** are followed in the **interim financial statements**. If those policies or methods have been **changed**, a description of the **nature** and **effect of the change** should also be given.

b) **Explanatory comments** about the **seasonality** or **cyclicality** of **interim operations**.

c) The **nature** and **amount** of items affecting **assets**, **liabilities**, **equity**, **net income** or **cash flows** that are **unusual** because of their **nature, size or incidence**.
d) The **nature** and **amount** of **changes in estimates** of amounts reported in **prior interim periods** of the current financial year or **changes in estimates** of amounts reported in the **prior financial year**.
e) **Issues, buy-backs, repayments** and **restructuring** of **debt** and **equity securities**.
f) **Dividends paid** (aggregate or per share) separately for **ordinary shares** and **other shares**.
g) **Segment information**:
• **Segment revenues**
• **Segment capital employed**
• **Segment result** for **business segments** or **geographical segments**
h) The effect of **changes in the composition** of the **enterprise** during the **interim period**.
i) **Material changes** in **contingent liabilities** since the **last annual balance sheet date**.

AS 5 – Disclosure of Changes in Accounting Estimates in Interim Reporting

- **Disclosure required** of the **nature** and **amount** of a **change in accounting estimate** if it has a **material effect** in the **current period** or is expected to affect **subsequent periods**.
- If a **significant change** in an **estimate** (made in an **interim period**) occurs in the **final interim period** of the financial year, but no **separate interim report** is prepared for that period → disclose the **nature** and **amount** of the change in a **note** to the **annual financial statements**.

Transitional provision

On the first occasion that an interim financial report is presented in accordance with this statement, the following need not be presented in respect of all the interim periods of the current financial year:

a. Comparative statements of profit and loss for the comparable interim periods of the immediately preceding financial year.
b. Comparative cash flow statement for the comparable year-to-date period of the immediately preceding financial year.

AS 28
IMPAIRMENT OF ASSETS

1. Introduction

1.1 Objective

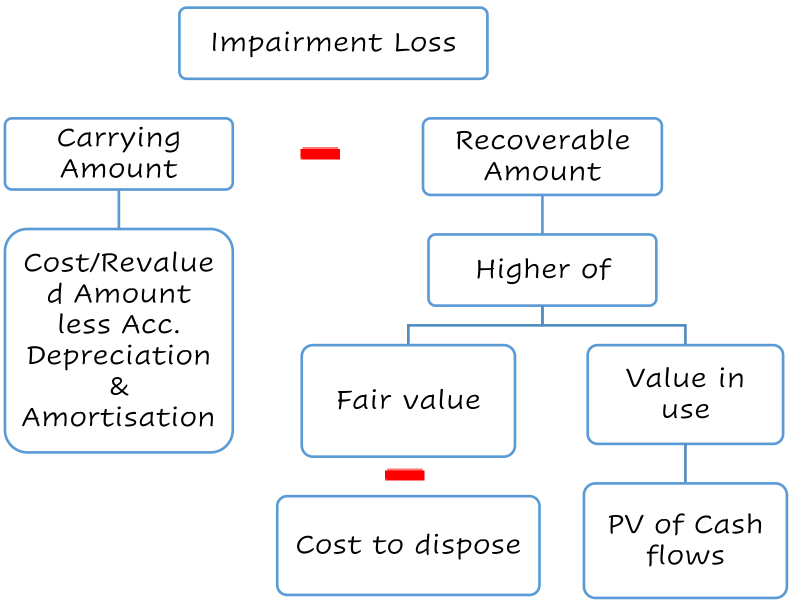
- Prescribe the methodology that an entity applies to ensure that its assets are not carried at more than their recoverable amount.
- Recognise impairment loss if the asset is carried at more than its recoverable amount.
- Specifies when an entity shall reverse an impairment loss
- Disclosure requirements

1.2 Scope

Applies to accounting for the impairment of all the assets **other than**

(a) Inventories	AS 2
(b) Contract assets and assets arising from costs to obtain or fulfil a contract	AS 7
(c) Deferred tax assets	AS 22
(e) Financial Assets including investments	AS 13

2. Definitions



2.1 Impairment Loss

It is the amount by which carrying amount exceeds the recoverable amount.

Impairment loss = Carrying Amount – Recoverable Amount

2.2 Recoverable Amount

The recoverable amount of an asset or a cash-generating unit is the **higher of its net selling price and its value in use.**

2.3 Value in Use

Present value of the future cash flows expected to be derived from an asset or cash-generating unit.

2.4 Net Selling Price

Amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable , willing parties, less the cost of disposal or **FV less cost to dispose**.

2.5 Costs of Disposal

Incremental costs directly attributable to the disposal of an asset or cash-generating unit, **excluding** finance costs and income tax expense.

2.6 Carrying Amount

Amount at which an asset is recognised **after deducting** any accumulated depreciation (amortisation) and accumulated impairment losses thereon. In other words carrying amount as per AS 10/26

2.7 Cash Generating Unit

A cash-generating unit is the **smallest identifiable group of assets** that generates cash inflows that are **largely independent of the cash inflows** from other assets or groups of assets. For e.g. a Hotel division of ITC group

3. Depreciation vs Impairment

Depreciation/ Amortisation	Impairment of Asset
(a) Reduction in the value of the asset	(a) Reduction in the value of the asset
(b) It is allocation of depreciable amount on a systematic basis.	(b) It is done only when there are indications that the asset was impaired.

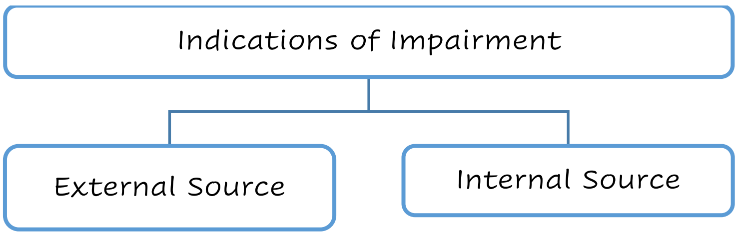
4. Identifying an Asset that may be impaired

4.1 General Rule –

Assess at the **each balance sheet date** whether there is **any indication** that an asset may be impaired.

If any indication exists, estimate the recoverable amount of the asset.

5. Indications of Impairment



5.1 External source of Information

(a) Significant decline in the market value. Because of this, fair value less cost of disposal will be reduced.

(b) Significant changes in technology, market, economic or legal environment with **adverse effect** on entity.

(c) Increase in market interest rates or rate of returns. This affects discount rate used in calculating asset's value in use and decrease asset's recoverable amount

(d) Carrying amount of net assets **>** Market capitalisation of entity

Sometimes the above indications **may not affect the specific company** and management may have their own strategies to overcome the challenges

For Example:

(i) Increase in short term interest rate may not have direct impact on the value in use in long run.

(ii) Increase in outflows may be compensated by increase in selling price

5.2 Internal sources of Information

(a) Obsolescence or physical damage of an asset.

(b) Significant changes in use or expected use of an asset with an **adverse effect** on the entity.

(c) Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

For Example:

Cash outflows for operating and maintaining asset **>** Budgeted
Actual net cash flows or operating profits **<** Budgeted
Decline in budgeted net cash flows / Increase in budgeted loss
Operating losses or net cash outflows for the asset, when current period amounts are aggregated with budgeted amounts for the future.

6. Value in Use

Value in use is the present value of the future cash flows expected to be derived from an asset or CGU

Value in Use involves following steps

Estimating future cash flows

Appropriate discount rate

6.1 Estimation of Expected Future cash flows

(a) Cash flow projections should be based on reasonable and supportive evidence.

(b) The estimations must be based on economic conditions that will exist over the remaining useful life of the asset

(c) Projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset and that can be directly attributed, or allocated on a reasonable and consistent basis to the asset.

(d) Net cash flows for the disposal of the asset at the end of its useful life.

6.1.1 Inclusions and Exclusions from Future cash flows –

Inclusions	Exclusions
(i) Cash flows from the continuing use of the asset	(i) Cash inflows from assets that generate cashflows that are largely independent from the asset under review. **Example:** Receivables recognised in BS

(ii) Net cash flows to be received (or paid) for the disposal of the asset at the end of its useful life. **(Estimated on arm's length transaction)**	(ii) Cash outflows that relate to obligations that have been recognised as liabilities. **Example:** Payables
(iii) cash flow to make asset ready to use	(iii) Cash flows from entity's restructuring plans which are not yet committed. If committed, its estimates of future cash outflows for the restructuring are included in a **restructuring provision** in accordance with **AS 29**
	(iv) Any internal charges incurred by the CGU for using corporate assets.
	(v) Future expenditure to enhance capacity of assets and cash inflows that are expected to arise from improving or enhancing the asset's performance in future.
	(vi) Cash flows from financing activities & taxes

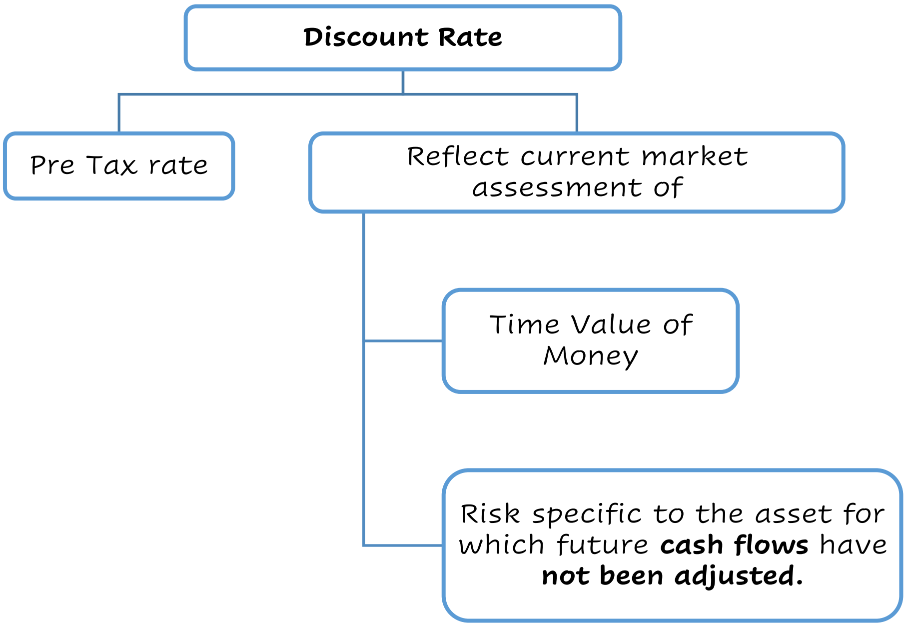
Other Important Points:

(i) For estimating net cash flow at the time of disposal, entity uses prices prevailing at the date of the estimate for similar assets that have reached the end of their useful life and have operated under conditions similar to those in which the asset will be used.

(ii) **Foreign currency future cash flows**

- Future cash flows are estimated in the currency in which they will be generated and then discounted using the discount rate appropriate for that currency.
- Convert cashflow in the reporting currency on the basis of AS 11.
- For example USD based cashflows are first discounted using USD appropriate interest rate and then converted to reporting currency.

6.2 Discount Rates



Risk Specific to the asset –

(i) Entity should use different rates for different assets or CGUs considering risks associated.

When **asset specific rate is not directly available** from the market, an entity uses other bases such as

(a) Weighted average cost of capital (WACC) determined using CAPM technique
(b) Enterprise incremental borrowing rate
(c) Other market borrowing rates.

(ii) The above rates can be adjusted by

- Adding specific risks associated with projected cash flows
- Excluding risks that are not relevant to the projected cash flows.
- Country risks, currency risks, price risks and cashflow risks are also to be considered.

7. Recognition and Measurement of Impairment Loss

7.1 Individual Assets

Impairment Loss	Recognise in P&L
If Asset was revalued earlier	- First Use revaluation surplus - balance is transferred to P&L
Depreciation	Calculated based on carrying amount after impairment.
Impairment loss > carrying amount of the asset	recognise a liability, if required by another standard say AS29

Journal Entry
Profit & Loss A/c Dr.
Revaluation Surplus Dr. (if asset is measured using revaluation model)
To Asset A/c

10.2 Cash Generating Unit

A cash generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets. For e.g. a Hotel division of ITC group.

7.1.1 Carrying amount of CGU

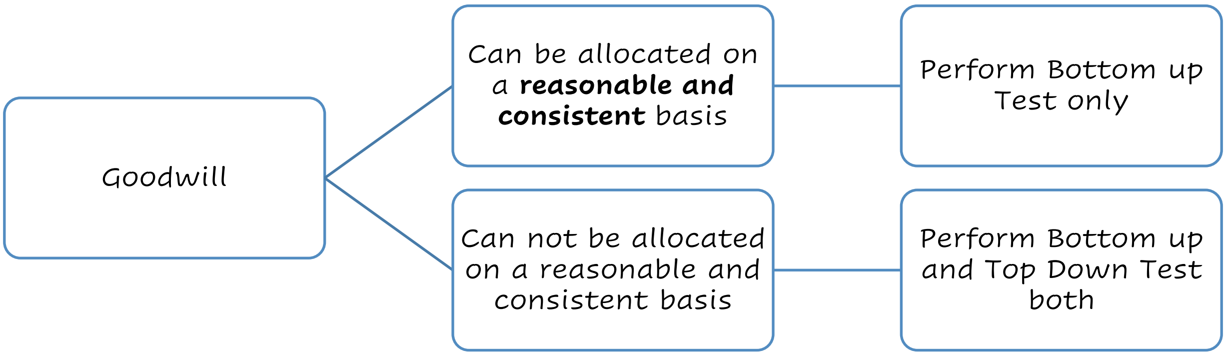
Inclusions	**Exclusions**
(i) Carrying amount of only those assets that can be attributed **directly**, or allocated on a **reasonable and consistent** basis, to the CGU and will generate future cash flows.	(i) Carrying amount of any recognised liability **unless** the recoverable amount of the cash-generating unit cannot be determined without consideration of this liability.

- If disposal of CGU would require the buyer to assume the liability,
NSP of CGU = Estimated selling price of assets & liability of CGU – cost of disposal.

- Carrying amount of liability is deducted in determining CGU's value in use and it's carrying amount to perform meaningful comparison.

8. Goodwill

1. Goodwill does not generate cash flows independently from other assets or groups of assets and therefore the recoverable amount of goodwill as an individual asset can not be determined.
2. If goodwill may be impaired ,recoverable amount is determined for CGU and it is compared to the carrying amount of CGU and impairment loss is recognized.

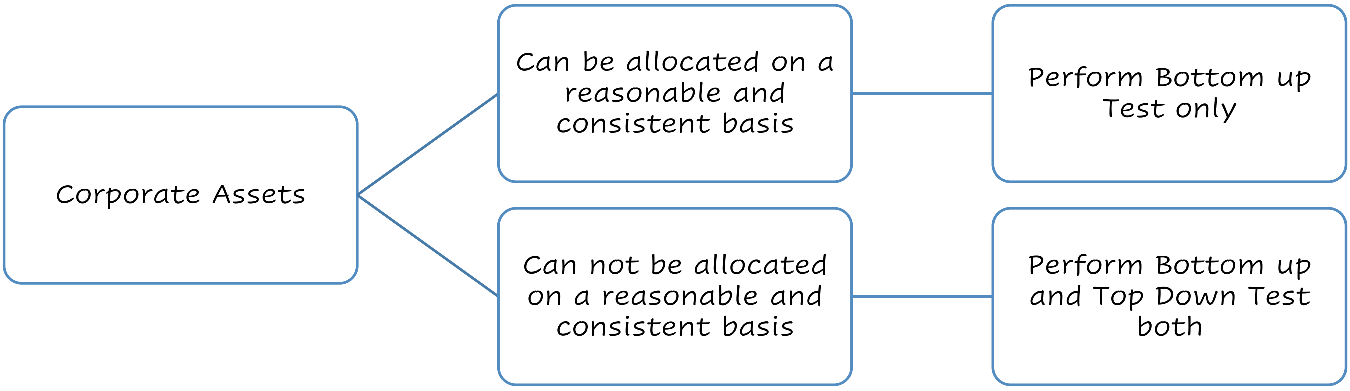


9. Corporate Assets

Corporate assets include group or divisional assets. They do **not generate** cash inflows **independently** of other assets or groups of assets and their carrying amount cannot be fully attributed to the cash-generating unit under review.

For Example:
Head office building, EDP equipment, research centre.

Corporate assets are tested for impairment in the context of the CGU or group of CGUs to which asset belongs.



Impairment loss for a cash generating unit

The impairement loss should be allocated to reduce the carrying amount of the assets of the unit in the following order

First, to goodwill allocated to the CGU

↓

Then , to the other assets of the unit on a pro-rata basis on the carrying amount of each asset in the unit

Carrying amount should not be reduced below the highest of:

a. Net selling price
b. Value in use
c. Zero

10. Reversal of an Impairment Loss

At every balance sheet date, entity should assess whether there is **any indication** that the impairment loss recognised in the previous years may be decreased or no longer exist. Entity must estimate recoverable amount of that asset if any such indication exists.

Impairment loss recognised for goodwill shall not be reversed in a subsequent period.

10.1 Change in Estimates

Impairment loss recognised in prior periods for an asset other than goodwill shall be reversed if, and only if, there has been a **change in the estimates** (of cashflows, discount rates etc) used to determine the asset's recoverable amount since the last impairment loss was recognised

10.2 Reversal of Impairment in case of Individual Asset

- **If Impairment loss was written off to profit and loss account**

  Reversal of impairment loss should be recognized as income in the financial statement immediately.

- **If Impairment loss was adjusted with the Revaluation Reserve**
  - Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation surplus and treated as per AS 10.
    - Credit to revaluation reserve
    - If P&L was debited earlier, credit P&L

The increased carrying amount of an asset due to a reversal of an impairment loss should not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior accounting periods.
After reversal of an impairment loss is recognised, the depreciation should be adjusted in future periods

10.3 Reversal of Impairment in case of CGU

A reversal if an impairment loss for a CGU should be allocated to **all** assets in CGU **except goodwill** on a pro rata basis of the carrying amount

The increase in **carrying amount of Individual Assets** in CGU shall **not be increased above the lower of**

- Its Recoverable Amount (If determinable)
- Actual carrying amount as if impairment loss had not been recognised previously

The amount of the reversal of the impairment loss should be allocated to each asset on a pro rata basis.

10.4 Reversal of Impairment loss for Goodwill

It does not permit an impairment loss to be reversed for goodwill because of a change in estimates. An impairment loss recognised for goodwill should not be reversed in subsequent period unless

a. Impairment loss was caused by a specific external event of exceptional nature that is not expected to recur.
b. Subsequent external events have occurred that reverse the effect of that event.

10.5 Impairment in case of Discontinuing Operations

Assets attributable to the discontinuing operation may be impaired or that an impairment loss previously recognised for those assets should be increased or reversed.

Enterprise determines whether the recoverable amount of an asset of a discontinuing operation is assessed for the individual asset or for the asset's cash-generating unit.

For example

a. If enterprise sells the discontinuing operation substantially ,none of the assets of the discontinuing operation generate cash inflows independently from other assets within the discontinuing operation.
b. If enterprise disposes of the discontinuing operation, such as piecemeal sales, the recoverable amount is determined for individual assets, unless the assets are sold in groups
c. If enterprise abandons the discontinuing operations, the recoverable amount is determined for individual assets.

11. Disclosures

11.1 General

The financial statements should disclose

a. The amount of impairment losses recognised in the statement of profit and loss during the period and the line of items in the statement of profit and loss in which those impairment losses are included
b. The amount of reversals of impairment losses recognised in the statement of profit and loss during the period and the line of items of the statement of profit and loss in which those impairment are reversed.

c. Impairment losses recognised directly against revaluation surplus during the period.
d. Reversals of impairment losses recognised directly in revaluation surplus.

12.2 Enterprise that applies AS 17, Segment Reporting should disclose the following

a. Impairment losses recognised in the P&L and directly against revaluation surplus.
b. Reversals of impairment losses recognised in the P&L and directly in the revaluation surplus.

11.2 Imparement loss for individual asset or CGU is recognised or reversed

a. The events and circumstances
b. Amount of imparment loss recognised or reversed.
c. For individual asset
   (i) Nature of the asset
   (ii) Reportable segment to whuch the asset belongs
d. For CGU
   (i) Description of CGU
   (ii) Amount of imparment loss recognised or reversed by class of assets and by reportable segment
   (iii) The current and former way of aggregating assets and the reasons for changing the way the CGU is identified.
e. The recoverable amount of the asset is its selling price or its value in use.
f. Basis used to determine net selling price.
g. The discount rate(s) used in the current estimate and previous estimate of value in use.

11.3 Impairment losses recognised (reversed) during the period are material in aggregate to the financial statements of the reporting enterprise as a whole

a. The main classes of assets affected by impairement losses
b. The main events and circumstances that led to the recogintion and reversal of these imparment losses.

PREPARATION OF FINANCIAL STATEMENTS

Companies Act – Provisions

- **Section 128 –** A company shall prepare and keep books of accounts and other relevant books and financial statements.
    - Where – At registered office / BOD to inform ROC if books kept at other places.
    - Method of accounting – Accrual basis and double entry system
    - Books should give a true and fair view.
    - Branches – Keep books at branch and periodic summarised returns to be submitted to HO.
    - Inspection – Directors during business hours
    - Period of retention – 8 Years
- **Electronic Mode**
    - Books of account and relevant papers can be kept in electronic mode as prescribed.
    - Electronic records must remain accessible in India at all times for subsequent reference.
    - From April 1, 2022, companies using accounting software must use software with an audit trail feature for each transaction.
    - Books and records must be retained in their original format or a format accurately presenting the information.
    - Information received from branch offices should not be altered and must depict the original content.
    - Electronic records must be capable of being displayed in a legible form.
    - Backup of electronic records, including those outside India, must be kept in servers physically located in India daily.
    - The company must annually provide information to the Registrar about the service provider, IP address, location, and, if on the cloud, the address provided by the service provider.
    - "Electronic mode" includes "electronic form" and "electronic record" as defined in the Information Technology Act, 2000.
    - The term "books of account" has the meaning assigned to it under the Act.
    - If the service provider is outside India, the name and address of the person in control of the books of account in India must be provided.

- **Statutory Books**

The following statutory books are required to be maintained by a company under different sections of the Companies Act, 2013:

- Register of Investments of the company held in its own name (Section 187)
- Register of Charges (Section 85)
- Register of Members (Sections 88)
- Register of Debenture-holders and other Security holders (Section 88)
- Minute Books (Section 118)
- Register of Contracts, or arrangements in which directors are interested (Section 189)
- Register of directors and key managerial personnel and their shareholding (Section 170)
- Register of Loans and Investments by Company (Section 186)
- In addition, a company usually maintains a number of statistical books to keep a record of its transactions which have resulted either in the payment of money to it or constitute the basis on which certain payments have been made by it.
- Registers and documents relating to the issue of shares are:
    - Share Application and Allotment Book;

- Share Call Book
- Certificate Book
- Register of Members
- Share Transfer Book
- Dividend Register.

- **Annual Return – Section 92**
  - Every company should prepare an annual return in prescribed form
  - Signed by a director and CS and if No CS, then by a Practicing CS.
    - Small & One Person Company – By CS and If No CS – by Director
  - Timeline – 60 days from the day of AGM. If no AGM withing 60 days form the date on which AGM should have been held.

- **Section 129** - At the AGM(Annual General Meeting) of a company, the Board of Directors of the company should lay financial statements before the company

Financial Statements
As per Section 2(40) of the Companies Act, 2013

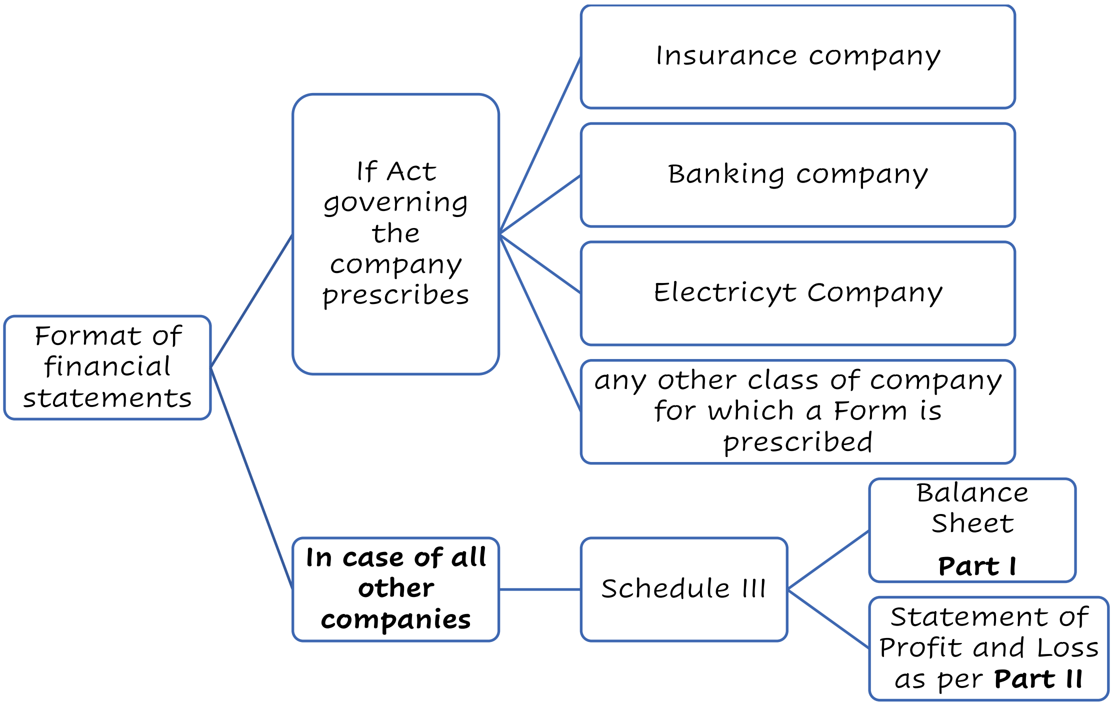
- Balance sheet
- Profit and loss account, OR
  Income and expenditure account
  (in the case of a company carrying on any activity not for profit)
- Cash flow statement
- A statement of changes in equity, if applicable
- Any explanatory note (Notes to Financial Statements)

The financial statement, with respect to One Person Company, Small company and Dormant company, does not include the cash flow statement.

- **Objective of financial statements -** It should give a true and fair view of the state of affairs of the company as at the end of the financial year.

- **Points to be kept in mind while preparing final accounts**
  - Requirements of Schedule III to the Companies Act
  - Other statutory requirements;
  - Accounting Standards notified by Ministry of Corporate Affairs (MCA)(AS 1 to 29);
  - Statements and Guidance Notes issued by the Institute of Chartered Accountants of India (ICAI);

★ **Section 133 of the Companies Act -** It is mandatory to comply with accounting standards notified by the Central Government from time to time.



Rounding off Requirement

Total Income	Rounding off
< 100 crores	Nearest hundreds, thousands, lakhs, millions or decimals thereof
>= 100 crores	Nearest lakhs, millions or crores or decimals therof.

PART-I – FORM OF BALANCE SHEET

Name of the Company: ....

Balance Sheet as at: ....

Sr.No.	Particulars	Note no.	Current Year	Previous Year
I	**Equity and Liabilities**			
1	Shareholders' Funds			
	(a) Share Capital (b) Reserves & Surplus (c) Money received against Share Warrants			
2	Share application money pending allotment			
3	Non-Current liabilities			
	(a) Long-term Borrowings (b) Deferred Tax Liabilities (Net) (c) Other long-term liabilities (d) Long-term Provisions			
4	Current liabilities			
	(a) Short-term Borrowings (b) Trade Payables (c) Other Current liabilities (d) Short-term Provisions			
	TOTAL			
II	**Assets**			
1	Non-Current assets			
	(a) PPE (property, plant & Equipment) & Intangible Assets (i) Property, Plant and Equipment (ii) Intangible assets (iii) Capital WIP (iv) Intangible assets under development			
	(b) Non-Current investments (c) Deferred tax assets (DTA) (Net) (d) Long-term loans & advances (e) Other Non-Current assets			\
2	Current assets			
	(a) Current investments (b) Inventories (c) Trade receivables (d) Cash & Cash equivalents (e) Short-term loans & advances (f) Other Current assets			
	TOTAL			

DISCLOSURE REQUIREMENTS IN RESPECT OF BALANCE SHEET

The disclosure requirements and the points to be kept in mind with regard to each of the above items is as follows:

1. **SHARE CAPITAL**

(a) Authorized Capital – to be shown separately

- It is the maximum number and face/par value, of each class of shares that a corporate entity may issue in accordance with its instrument of incorporation.
- Face/Par Value, as per Capital Clause in Memorandum of association should be disclosed.
- Separate disclosure for both Equity and Preference Shares.

(b) Number of Shares issued, Subscribed and Fully Paid, and Subscribed but not Fully Paid

- **"Subscribed Share Capital"** is "that portion of the issued Share Capital which has actually been subscribed by the public and subsequently allotted to the shareholders by the entity. This also includes any Bonus shares issued to the Shareholders.
- **"Paid-up Share Capital"** is "that part of the Subscribed Share Capital for which consideration is cash or otherwise has been received. This also includes Bonus Shares allotted and Shares issued otherwise than for cash against purchase consideration, by the corporate entity."
- If Shares are not fully called, then disclose the called up value per share.
- Separate disclosure for both Equity and Preference Shares, which should again be sub-classified and represented for each class of Shares.

(c)Rights, Preferences and restrictions attaching to shares including restrictions on the distribution of dividends and the repayment of Capital

- All such Rights, Preferences and Restrictions attached to each class of Shares, terms of redemption, etc., should be disclosed separately.
- Further, Preference Shares can be cumulative, non-cumulative, redeemable, convertible, non-convertible, etc

(d) Disclose number of Shares held by the entire chain of Subsidiaries and associates starting from the Holding Company and ending right up to the ultimate Holding Company.

- All such disclosures should be made separately representing for each class of Shares, (for both equity and Preference Shares).

(e) List of Shareholders holding more than 5% shares as on the Balance Sheet date

- If during the year, any Shareholder held more than 5% equity Shares but does not hold as much at the Balance Sheet date, disclosure is not required.
- Companies should disclose the Shareholding for each class of Shares, both within equity and Preference Shares. So, such% should be computed separately for each class of Shares.
- This information should also be given for comparative previous period.

(g) Shares reserved for issue under Options and Contracts/ commitments for the sale of Shares/ disinvestment, including the terms and amounts

- Shares under Options generally arise under Promoters or Collaboration agreements, loan agreements or debenture deeds (including Convertible debentures), agreement to convert Preference Shares into equity Shares, ESOPs or Contracts for supply of Capital Goods, etc.
- Disclosure is required for the Number of Shares, amounts and Other terms for Shares so reserved.
- Such options are in respect of unissued Portion of Share Capital

(h) For the period of 5 years immediately preceding the date as at which the Balance Sheet is prepared-

- **Aggregate Number & Class of Shares allotted as Fully Paid and up Pursuant to Contract(s) without payment being received in Cash [Non Cash Issue]**
- **Aggregate No. and Class of Shares allotted as fully Paid up by way of Bonus Shares**
- **Aggregate Number & Class of Shares bought back**

➢ Disclose only if such event has occurred during a period of 5 years immediately preceding the Current year Balance Sheet date

➢ If the company is in operation for a period of less than 5 years, then disclosure should cover all such earlier financial years

➢ The following allotments are considered as Shares allotted for payment being received in cash, and hence should not be disclosed under this Clause –

(a) If the subscription amount is adjusted against a bonafide debt payable in money at once by the Company,

(b)Conversion of loan into Shares in the event of default in repayment

(i) Terms of any Securities Convertible into Equity / Preference Shares issued along with the earliest date of conversion in descending order starting from the farthest such date.

➢ In case of Compulsorily Convertible Securities, where conversion is done in fixed tranches, all the dates of conversion have to be considered.

➢ In case of Convertible Debentures/Bonds, etc., for the purpose of simplification, reference may also be made to the terms disclosed under the note on long term Borrowings where these are required to be classified in the Balance Sheet, rather than disclosing the same against under this Clause.

(j) Calls Unpaid (showing aggregate value of Calls Unpaid by Directors and Officers)

➢ Unpaid amount towards Shares subscribed by the Subscribers of Memorandum of association should be considered as 'Subscribed and paid-up Capital' in the Balance Sheet and the debts due from the Subscribers should be appropriately disclosed as an asset in the B/Sheet.

(l) Forfeited Shares (amount originally paid up)

(m) Shares held by promoters at the end of year

Name of Promoter	No of Shares	% of total shares	% change during the year

2. RESERVES & SURPLUS

Reserves & Surplus shall be classified as –
(a) Capital reserves
(b) Capital redemption reserve
(c) Securities Premium
(d) Debenture redemption reserve
(e) Revaluation reserve
(f) Share Options Outstanding account
(g) Other reserves
(h) Surplus, i.e., balance in Statement of P&L disclosing allocations & appropriations, such as, dividend, Bonus Shares and transfer to/from reserves, etc.

➢ Additions & deductions since last Balance Sheet to be shown under each of specified heads.

➢ Appropriations to the Profit for the year (including carried forward balance) is to be presented under the main head 'Reserves and Surplus'.

➢ Under Sch III, the Statement of P&L will no longer reflect any appropriations, like Dividends transferred to reserves, Bonus Shares, etc.

➢ A Reserve specifically represented by Earmarked Investments shall be termed as a 'Fund'.

➢ Debit Balance Statement of P&L shall be shown as a Negative Figure under the head 'Surplus'. Similarly, the balance of 'reserves & Surplus', after adjusting Negative balance of Surplus, if any, shall be shown under the head 'Reserves & Surplus' even if the resulting figure is in the negative.

- **Capital Reserve –** It is a Reserve of a Corporate enterprise which is not available for distribution as dividend.

Profit on Re-issue of Forfeited Shares is basically profit of a Capital Nature and, hence, it should be credited to Capital reserve.

- **Capital redemption reserve (CRR)** is required to be created u/s 55 and 68 (for redemption of Preference Share Capital and buyback of Equity Share Capital), subject to conditions specified in the respective Sections.
- **Debenture Redemption Reserve (DRR)** is required to be created u/s 71, and maintained until such debentures are redeemed. On redemption of the debentures, the amounts no longer necessary to be retained in this account should be transferred to the General reserve.
- **Revaluation reserve** is a reserve created on the revaluation of assets or Net assets of an enterprise represented by the surplus of the estimated Replacement Cost or estimated market values over the Book Values thereof.
- As per ICAI Guidance Note on ESOP, **Share Options Outstanding** should be shown as separate line item. Under Schedule III, this line item should be shown separately under reserves & Surplus.
- **Other reserves** - This includes any other Statutory reserves, e.g. tonnage tax reserve to be created under the income tax act, 1961.

3. MONEY RECEIVED AGAINST SHARE WARRANTS

This is to be shown as a separate line item on the face of Balance Sheet. Since Shares are yet to be allotted against the same, these are not reflected as a part of Share Capital, but as a separate line-item.

4. SHARE APPLICATION MONEY PENDING ALLOTMENT

- Share application Money not exceeding the issued capital and to the extent not refundable is to be disclosed as a separate line item after "Share Holders Funds" and before "Non-Current Liabilities".
- If the Company's issued Capital is more than the authorized Capital, and approval of increase in authorized Capital is pending, the amount of Share application Money received over and above the authorized Capital should be shown under the head "Other Current Liabilities".
- The amount shown as 'Share application Money Pending allotment' will not include Share application Money to the extent refundable, for example, the amount in excess of issued Capital, or where Minimum Subscription requirement is not met. Such amount will have to be shown separately under 'Other Current liabilities.
- Calls Paid in Advance are to be shown under "Other Current liabilities". the amount of interest which may accrue on such advance should also is to be reflected as a liability.

5. NON-CURRENT LIABILITIES

(A) LONG-TERM BORROWINGS

Long-Term Borrowings shall be classified as –

a) Bonds/debentures,
b) Terms Loans – (i) from Banks, and (ii) from Other Parties,
c) Deferred Payment liabilities,
d) Deposits,
e) Loans & advances from related Parties,
f) Long-term Maturities of Finance lease Obligations,
g) Other loans & advances (specify nature)

1. Definitions and Meanings:

- Loans with repayment period beyond 36 months are usually known as "**Term Loans**". So, Cash Credit, Overdraft and Call Money accounts/ deposits are not covered by the expression "Term Loans".
- **Deferred Payment liabilities** would include any liability for which payment is to be made on deferred credit terms, e.g., Deferred Sales tax liability, Deferred Payment for Acquisition of fixed Assets, etc.
- **Deposits** classified under Borrowings would include deposits accepted from Public and inter-Corporate deposits which are in the nature of Borrowings.
- **Loans and advances** from related parties are required to be disclosed. advances under this head should include those advances which are in the nature of loans.

2. Security-wise Classification:

- Borrowings shall further be sub-classified as Secured and Unsecured. Nature of Security shall be specified separately in each case.
- However, where one security is given for multiple loans, the same may be clubbed together for disclosure purposes with adequate details of cross referencing.
- Disclosure about the nature of security should also cover the type of asset given as security, e.g., Inventories, Plant and Machinery, land and Building, etc.
- When Promoters, other Shareholders or any third party have given any personal security for any borrowing, e.g., Shares or Other assets held by them, disclosure should be made thereof, though such security does not result in the classification of such borrowing as secured.

3. Guarantees:

- Where loans have been guaranteed by directors or Others, the aggregate amount of such

loans under each head shall be disclosed.

- Others" would mean any Person or entity other than a director, e.g., related Parties, or any person associated with the Company in some manner.

4. Maturity Date wise:

- Bonds / debentures (along with rate of interest & particulars of redemption or Conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest redemption or Conversion date, as the case may be.
- Current Maturities of all Long-Term Borrowings will be disclosed under "Other Current Liabilities" and not under long-term Borrowings and Short-term Borrowings.
- So, it is possible that the same Bonds/Debentures/ Term Loans may be bifurcated under both "Long-term Borrowings" as well as under "Other Current liabilities".

5. Installment redemption:

- Where Bonds/ debentures are redeemable by installments, the date of Maturity for the purpose must be reckoned as the date on which the First installment becomes due.

6. Power to reissue:

- Particulars of any redeemed Bonds/debentures which the Company has power to reissue shall be disclosed.

7. Terms of repayment:

- Repayment of term loans and Other loans shall be stated.
- Disclosure of terms of repayment should be made preferably for each loan unless the repayment terms of individual loans within a category are similar, in which case, they may be aggregated.

8. Continuing Default:

- Period and amount of continuing default as on the Balance Sheet date in repayment of loans and interest, shall be specified separately in each case.

- The term "Continuing Default" is used w.r.t. Long Term Borrowings, whereas the term "Default" is used w.r.t. Short-term borrowings.
- Under CARO, the Auditor shall report on the default made and the period of default.
- Defaults other than in respect of repayment of loan and interest, e.g., non-compliance with debt Covenants, etc., need not be disclosed.
- Any default that had occurred during the year and was subsequently made good before the end of the year need not be disclosed.

(B) DEFERRED TAX LIABILITIES – AS 22

- To be shown as a separate line item on the face of Balance Sheet.

(C) OTHER LONG-TERM LIABILITIES

It shall be classified as –

(a) Trade Payables

(b) Others

- Sundry Creditors for Goods or Services, and acceptances should be disclosed as part of trade Payables.
- Disclosure requirements under Micro, Small & Medium enterprises development (MSMED) act will also be required to be made in the annual Financial Statements.
- Amounts due under contractual obligations, e.g., payables in respect of statutory obligations, like contribution to Provident Fund, Purchase of Fixed assets, Contractually reimbursable expenses, interest accrued on trade Payables, etc., should be classified as "Others" and each such item should be disclosed nature wise.

(D) LONG-TERM PROVISIONS

It shall be classified as –

(a) Provision for Employee Benefits

(b) Others (Specifying nature)

- This should be classified into short-term and long-term portions, and the latter amount should be included here.
- "Others" would include items like Provisions for Warranties.

(6) CURRENT LIABILITIES

(A) SHORT-TERM BORROWINGS

Short-Term Borrowings shall be classified as –

(a) Loans Repayable on demand– (i) from Banks, & (ii)Other Parties,

(b) Loans and Advances from Related Parties,

(c) Deposits,

(d) Other Loans and Advances (specify nature)

(e) Current maturity of long term borrowings

1. Definition & meaning:

- Short-Term Borrowings will include all Loans within a period of 12 months from the date of the loan, loans payable on demand, etc., and they will include Current Maturity of long-term Borrowings
- In case of Short-Term Borrowings, all defaults (not continuing defaults as in the case of long-term Borrowings) existing as at the date of the Balance Sheet should be disclosed (item wise)
- A 3-Year Loan taken for a business with a 4-year Operating Cycle will be categorized only as Short term Borrowings, and not as long-term Borrowings.

2. Security wise Classification:

- Borrowings shall further be sub-classified as Secured and Unsecured.
- Nature of security shall be specified separately in each case.

3. Guarantees:

- Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.

4. Default:

- Period & amount of default as on B/Sheet date in repayment of loans and interest shall be separately in each case.

(B) TRADE PAYABLES

It shall be classified as –
(a) Total outstanding dues of micro enterprises and small enterprises; and
(b) Total outstanding dues of creditors other than micro enterprises and small enterprises."

- Liability for Capital goods Purchases: Amount due towards purchase disclosed under "Other Current liabilities" with a suitable description.
- Liability under Contractual Obligations: Liability towards employees, leases or other Contractual liabilities should not be included under trade Payables.
- Only "Commercial Dues" can be included under trade Payables.

The following details relating to Micro, Small and Medium enterprises shall be disclosed in the notes:
(a) the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year;
(b) the amount of interest paid by the buyer along with the amount of the payment made to the supplier beyond the appointed day during each accounting year;
(c) The amount of interest due and payable for the period of delay in making payment (which have been paid but beyond the appointed day during the year) but without adding the interest specified under the Micro, Small and Medium enterprises development act, 2006;
(d) the amount of interest accrued and remaining unpaid at the end of each accounting year; and
(e) the amount of further interest remaining due and payable even in the succeeding years, until such date when the interest dues above are actually paid to the small enterprise, for the purpose of disallowance of a deductible expenditure under Section 23 of the Micro, Small and Medium enterprises development act, 2006.

Ageing Schedule

Particulars	Outstanding for a period				Total
	<1 Year	1-2 Years	2-3 years	>3 Years	
MSME					
Others					
Disputed – MSME					
Disputed - Others					

(C) OTHER CURRENT LIABILITIES

It shall be classified as –

- Current Maturities of Finance lease Obligations,
- interest accrued but not due on Borrowings,
- interest accrued and due on Borrowings,
- income received in advance,
- unpaid dividends,
- application Money received for allotment of Securities and due for refund and interest accrued thereon

- unpaid Matured deposits and interest accrued thereon,
- unpaid Matured debentures and interest accrued thereon,
- Other Payables (specify nature).

- The portion of Long-Term Debts/ Lease Obligations, which is due for payments within 12 months of the reporting date is required to be classified under "Other Current Liabilities", while the balance amount should be classified under long-term Borrowings.
- Trade Deposits and Security Deposits which are not in the nature of Borrowings should be

classified separately under Other Non-Current/ Current liabilities.

- 'Other Payables' under this head may be in the nature of statutory dues such as withholding taxes, Service tax, VAT, Excise duty, etc.
- Current/Non-current Classification of Assets / Liabilities is determined on a particular date, i.e., Balance Sheet date. So, if there is any change in the position at the end of the current year resulting in a different classification of Assets / Liabilities in the current year, it will not impact the classification made in the previous year.

(D) SHORT TERM PROVISIONS

It shall be classified as –
(a) Provision for Employee Benefits
(b) Others (Specifying nature)

- This should be classified into short-term and long-term portions, and the former amount should be included here.
- "Others" includes Provision for dividend, Provision for taxation, Provision for Warranties, etc.

(1) NON-CURRENT ASSETS

(A) (I) PROPERTY, PLANT & EQUIPMENT – AS 10

1. Classification shall be given as –
(a) Land,
(b) Buildings,
(c) Plant and equipment,
(d) Furniture & Fixtures,
(e) Vehicles,
(f) Office Equipment,
(g) Others (Specify Nature).

- **AS-19** excludes land leases from its scope. Leasehold land should be presented as a separate assets class under Tangible Assets. Also, Freehold land should be presented as a separate asset class.
- Assets under Lease shall be separately specified under each class of asset. The term "under lease" should mean –
  - Assets given on Operating lease in the case of lessor, and
  - Assets held under Finance lease in the case of lessee.
- Leasehold Improvements should continue to be shown as a separate asset class.
- **AS-10** requires disclosure of details such as Gross Book Value of Revalued Assets, Method adopted to compute revalued amounts, Nature of indices used, year of appraisal, involvement of external valuer, etc. as long as the concerned assets are held by the Enterprise.
- Since reconciliation of Gross and Net Carrying amounts of Fixed assets is required, the depreciation/ Amounts of fixed assets is required, the

Depreciation/ amortization for each class of asset should be disclosed in terms of –

- Opening Accumulated Depreciation,
- Depreciation/Amortization for the year,
- Deductions/Other Adjustments, and
- Closing Accumulated Depreciation/ Amortization

➢ Similar disclosures should also be made for impairment, if any, as applicable.

➢ **Business Combinations**: Business Combination should be taken as an amalgamation or acquisition or any other mode of restructuring of a set of assets and/or a group of assets and liabilities constituting a business.

➢ Acquisitions through 'Business Combinations' should be disclosed separately for each class of assets.

➢ Asset Disposals through Demergers, etc., if any also be disclosed separately for each class of assets.

➢ **Other Adjustments**: This includes –

- Capitalization of FOREX Differences where such option has been exercised by the Company as per **AS-11**.
- Adjustments on a/c of Exchange Fluctuations for Fixed assets in case of Non-integral Operations (AS11).
- Borrowing Costs capitalized as per **AS-16**.

(A) (II) INTANGIBLE ASSETS

Classification shall be given as –
(a) Goodwill, (b) Brands / Trademarks, (c) Computer Software, (d) Mastheads and Publishing titles, (e) Mining rights, (f) Copyrights, and Patents and Other intellectual Property rights, Services and Operating rights, (g) recipes, Formula, Models, designs and Prototypes, (h) licenses and Franchise, (i) Others (specify nature).

➢ Intangible assets under development should also be disclosed separately, if aS-26 criteria are met.

➢ **AS-26** does not permit revaluation of intangible assets.

(A) (III) CAPITAL WORK IN PROGRESS

➢ To be shown as a separate line item on the face of Balance Sheet .

➢ Capital advances should be included under long term loans and advances and hence, cannot be included under Capital WIP.

(A) (IV) INTANGIBLE ASSETS UNDER DEVELOPMENT

➢ Intangible assets under development should be disclosed under this head provided they can be recognized based on the criteria laid down in AS-26.

(B) NON CURRENT INVESTMENTS

Non-Current Investments shall be classified as Trade investments and Other investments, and
further classified as Investments in –
(a) Property,
(b) Equity instruments,
(c) Preference Shares,
(d) Government / trust Securities,
(e) Debentures or Bonds,
(f) Mutual Funds,
(g) Partnership Firms, and
(h) Other Non-Current investments (specify nature).

- If a Debenture is to be redeemed partly within 12 months and balance again after 12 months, the amount to be redeemed within 12 months should be disclosed as current, and balance as Non-Current.
- "Trade Investment" is normally understood as an investment made by a Company in Shares or debentures of another Company, to promote the trade or business of the first Company.
- Under each classification, details shall be given about
  - The names of Bodies Corporate (indicating separately whether such bodies are – Subsidiaries, (ii) associates, (iii) Joint Ventures, or (iv) Controlled Special Purpose entities) in whom investments have been made and
  - The nature and
  - Extent of the investment so made in each such Body Corporate (showing separately investments which are partly-paid).
- "Nature and Extent" of Investment in each Body Corporate should be interpreted to mean the number and face value of Share.
- Also, it is advisable to clearly disclose whether investments are fully paid or partly paid. (itemwise)
- With regard to investments in the capital of Partnership Firms, the Names of the Firms (with the names of all their Partners, total Capital and the Shares of each Partner) shall be given.
- Investments in LLPs will be disclosed separately under "Other Investments".
- In case of change in constitution of the Firm during the year, the names of the other partners should be disclosed based on the position existing as on the date of Company's Balance sheet.
- Investments carried at other than at Cost should be separately stated specifying the basis for valuation thereof.
- Basis could be (a) Cost, or (b) Cost less Provision for other than temporary diminution, or

(c)Lower of Cost and Fair Value.

- The following shall also be disclosed- (a) aggregate amount of Quoted investments and Market Value thereof, (b) Aggregate Amount of unquoted investments, (c) aggregate Provision for diminution in value of investments.

(1) (C) DEFERRED TAX ASSET

To be shown as a separate line-item on the face of Balance Sheet.

(1) (D) LONG TERM LOANS AND ADVANCES

1. **General Classification**: Long-term loans and advances shall be classified as –
(a) Capital advances,
(b) Security deposits,
(c) Loans and advances to related Parties (giving details thereof),
(d) Other loans and advances (specify nature)

- Capital Advances are advances given for procurement of Fixed assets which are Non-Current Assets. They are not realized back in cash, and over a period, get converted into Fixed assets.
- Other loans and Advances should include all other items in the nature of advances recoverable in cash or kind, e.g., Prepaid Expenses, Advance Tax, CENVAT Credit receivable, VAT Credit receivable and Service tax Credit receivable which are not expected to be realized within the next 12 months or operating cycle whichever is longer, from the Balance Sheet date.

2. **Security wise Classification**: the above shall be separately sub-classified as –
(a) Secured, considered Good
(b) Unsecured, considered Good
(c) Doubtful.

3. **Bad / Doubtful**: allowance for Bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

4. **Directors, etc.**: loans and advances due by Directors or Other Officers of the Company or any of
them either severally or jointly with any other persons or amounts due by Firms or Private Companies respectively in which any director is a Partner in a director of a Member should be separately stated.

(1) (E) OTHER NON-CURRENT ASSETS

1. General classification - Other Non-Current Assets shall be classified as
(a) long-term trade receivables (including trade receivables on deferred Credit terms)
(b) Others (specify nature)

- Dues in respect of Insurance Claims, Sale of Fixed assets, Contractually reimbursable expenses, interest accrued on trade receivables, etc., should be classified as "Others" and each such item should be disclosed according to their nature.

2. Security wise Classification:
3. Bad / Doubtful:
4. Directors, etc.:

Same as above.

(2)CURRENT ASSETS

(2) (A) CURRENT INVESTMENTS

Current Investments shall be classified as –
(a) investments in equity instruments,
(b) investment in Preference Shares,
(c) investments in Government or trust Securities,
(d) investments in debentures or Bonds,
(e) investments in Mutual Funds,
(f) investments in Partnership Firms,
(g) Other investments (specify nature)

Principles given for Non-current investments will apply here also to the relevant. However, trade vs Non-Trade Classification, is not required for Current investments.

(2) (B) INVENTORIES

Inventories shall be classified as –
(a) Raw materials,
(b) Work In Progress,
(c) Finished Goods,
(d) Stock-in-Trade (in respect of goods acquired for
trading),
(e) Stores and Spares,
(f) Loose tools,
(g) Others (specify nature)

- Goods in Transit should be included under relevant heads with suitable disclosure.
- The heading "Finished Goods" should comprise all Finished Goods other than those acquired for trading purposes.
- Those acquired for trading purposes are to be shown under "Stock in Trade".

(2) (C) TRADE RECEIVABLES

Ageing to be provided

Particulars	Outstanding for a period		

	< 6 months	6m – 1 year	1 – 2 years	2-3 Years	> 3 Years	Total
Undisputed – Good						
Undisputed – Doubtful						
Disputed – Good						
Disputed - Doubtful						

2. Security wise Details: trade receivables shall be separately sub classified as –
(a) Secured, considered Good
(b) Unsecured, considered Good
(c) Doubtful.

3. Bad /Doubtful: Allowance for Bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

4. Directors, etc: debts due by directors or Other Officers of the Company or any of them either
severally or jointly with any other person or debts due by Firms or Private Companies, respectively in which any director is a Partner, or a director, or a Member should be separately stated.

- Where no due date is specifically agreed upon, normal credit period allowed by the Company should be taken into consideration for computing the due date, which may vary depending upon the Nature of Goods or Services sold and the type of Customers, etc.
- Lean Period Activities: Receivables arising out of sale of materials / rendering of services during a Company's lean period, should be included under "Trade Receivables", if such activity is in the normal course of business. If they are not part of "normal course of business", they are to be classified under "Other Assets".

(2) (D) CASH AND CASH EQUIVALENTS

Cash and Cash Equivalents shall be classified as –
(a) Balances with Banks,
(b) Cheques, drafts on Hand,
(c) Cash on Hand,
(d) Other (Specify nature).

- Earmarked Balances with Banks (e.g. for Unpaid dividend) shall be separately stated.
- Balances with Banks to the extent held as margin Money or Security against the Borrowings, Guarantees, Other Commitments shall be disclosed separately.
- Repatriation restrictions, if any, in respect of Cash and Bank Balances shall be separately stated.
- Bank Deposits with more than 12 months Maturity shall be disclosed separately.

(2) (E) SHORT TERM LOANS AND ADVANCES

1. General Classification: Short-Term Loans and Advances shall be classified as –
(a) loans and advances to related Parties (giving details thereof),
(b) Others (specify nature).

2. Securitywise Classification: The above shall also be subclassified as-
(a) Secured, considered Good,

(b) unsecured, considered Good,
(c) doubtful

3. Bad / doubtful: allowance for Bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

4. Directors, etc.: loans & advances due by directors or Other Officers of the Company or any of them either severally or Jointly with any other person or amounts due by Firms or Private Companies, respectively in which any director is a Partner or a director or a Member shall be separately stated.

(2) (F) OTHER CURRENT ASSETS

- This is an all-inclusive heading, which incorporates Current Assets which do not fit into any other Asset Categories.

- Nature of each item should be specified.
- In case any amount classified under this category is doubtful, it is advisable that such doubtful amount as well as any provision made there against should be separately disclosed. e.g., unbilled revenue, unamortized Premium on Forward Contracts, etc.

Special note : Schedule III does not deal with any accounting treatment of special items (such as Share issue expenses, ancillary borrowing Costs and discount or Premium relating to borrowings), and the same continues to be governed by the respective AS / best practices. So, a Company can disclose the Unamortized Portion of such expenses as "Unamortized Expenses", under the head "Other Current/ Non Current assets", depending on whether the amount will be amortized in the next 12 months or thereafter.

PART II-FORM OF STATEMENT OF PROFIT AND LOSS

Name of the Company :...

Profit and loss Statement for the year ended:... (rs. in ....)

Sr.No.	Particulars	Note No.	Current Year	Previous Year
I	Revenue from Operations			
II	Other income			
III	**Total Income (I+II)**			
IV	Expenses			
	i. Cost of Materials Consumed ii. Purchases of Stock-In-Trade iii. Changes in inventories of Finished Goods / Work-in-progress and Stock-In-Trade iv. Employee Benefits Expense v. Finance Costs vi. Depreciation and amortization expense vii. Other expenses			
	Total expenses			
V	**Profit before Exceptional & Extraordinary items and tax (III – IV)**			
VI	Exceptional items			
VII	**Profit before Extraordinary Items and Tax (V-VI)**			
VIII	Extraordinary items			
IX	**Profit before Tax (VII-VIII)**			
X	Tax expenses: (1) Current tax (2) deferred tax			
XI	**Profit /(Loss) for the period from Continuing Operations (IX – X)**			
XII	Profit /(Loss) from Discontinuing Operations			
XIII	Tax expense of discontinuing Operations			
XIV	**Profit /(Loss) from Discontinuing Operations (after tax) (XII-XIII)**			
XV	Profit / (Loss) for the period (XI + XIV)			
XVI	**earnings per equity Share: (1) Basic (2) Diluted**			

Distributable/ Divisible Profit

- A dividend is a distribution of divisible profit of a company among the members according to the number of shares held by each of them in the capital of the company and the rights attaching thereto.
- Such a distribution may (in case of cash) or may not entail a release of assets (in case of bonus issue)
- Bonus shares cannot be issued in lieu of dividends.
- Capital cannot be returned to the shareholders by way of dividend.
- A company who has committed any default in compliance with the provisions of sec- 73 and 74 relating to the acceptance and repayment of deposits would be barred to declare dividend.
- Dividend should be declared or paid only from free reserves.
- Dividend shall be payable by way of

  (i) cash (ii) cheque (iii) warrant or (iv) in any electronic mode

  It shall be payable to the registered shareholder of such share or to his order or to his banker

- A company **may,** before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year, as it may consider appropriate to the reserves of the company.

  Appropriation of a part of profit can be done in the following cases

  1. When required under a law - For example, under the Banking Regulation Act

  2. When required under any contract – For example where the company has undertaken, at the time of raising of loan, that before any part of its profit is distributed, a specified percentage of the profit every year should be credited to a reserve for the repayment of the loan and until the time for repayment arrives, the amount should remain invested in a specified manner

  - A company may if so authorised by its Article, pay a dividend in proportion to the amount paid on each share in case of partly paid shares.
  - Calls paid in advance do not rank for payment of dividend.
  - Dividend on preference shares
    - Holders of preference shares are entitled to receive a dividend at a fixed rate before any dividend is declared on equity shares.
    - But such a right can be exercised subject to there being profits and the Directors recommending payment of the dividend.

  - As per Section 2 (35) of the Companies Act, 2013, term "Dividend" includes interim dividend also.

Final dividend	**Interim dividend**
Declared at the AGM	Declared between 2 AGMs
Paid after the finalization of accounts of the year	Paid before the finalization of accounts.
Dividend is recommended by BOD but approved by shareholders in AGM. (share holders can reduce the rate of dividend but they cannot increase it)	This dividend is declared by BOD.
Once it is declared it becomes the liability of the company and it must pay the amount.	This can be revoked with the consent of the shareholders

Sec 123 (3) - In case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend should not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

Dividends can be declared out of [sec 123(1)]

Out of current year profits	Out of accumulated profits	Out of both current year and accumulated profits	Out of the moneys provided by the Central or any State Govt
Condition - provide for depreciation as per the provisions of section 123(2)	Condition - (i) provide for current year & arrears of depreciation of past years as per sec 123(2) **+** (ii) Compliance of Companies (Declaration & Pmt of Dividend) Rules, 2014	Condition - Provide for depreciation	in pursuance of any guarantee given by that Govt

Sec 123(2) - Depreciation must be to the extent specified in Schedule II to the Companies Act, 2013.

- When the assets are sold, discarded, demolished or destroyed in any financial year, the excess of the written down value over its sale proceeds as scrap, if any should be written off in the same financial year.

Conditions as per Companies (Declaration and Payment of Dividend) Rules, 2014

(1) The **rate of dividend** declared should not exceed the **average of the rates at which dividend was declared by it in the three years** immediately preceding that year.
   - This condition is not applicable in case the company has not declared any dividend in each of the three years.

(2) The **total amount to be drawn** from such accumulated profits should not exceed one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.

(3) The **amount so drawn should first be utilised** to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.

(4) The **balance of reserves** after such withdrawal should not fall below 15% of its paid up share capital as appearing in the latest audited financial statement.

(5) No company should declare dividend unless **carried over previous losses** and depreciation not provided in previous year, are set off against profit of the company of the current year. The loss or depreciation, whichever is less, in previous years is set off against the profit of the company for the year for which dividend is declared or paid.

Sec 124 - Payment of dividend

(1) **Deposit in separate bank** - The amount of the dividend, including interim dividend, should be deposited in a scheduled bank in a separate account **within 5 days** from the date of declaration of such dividend.

(2) **Mandatory payment** - The dividend declared should be **paid** to the share holder **within 30 days** from the date of declaration.

(3) **Transfer to unpaid dividend account** – Where any dividend has not been paid or claimed within thirty days from the date of the declaration to any shareholder the company should, **within 7 days** from the date of expiry of the said period of 30 days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the Unpaid Dividend Account.

(4) **Statement to be placed on website** – The company should, **within a period of 90 days** of making any transfer to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place it on the website of the company, if any, and also on any other website approved by the Central Government for this purpose, in such form, manner and other particulars as may be prescribed.

(5) **Interest of 12% in case of default –** If any default is made in transferring any amount to the Unpaid Dividend Account, the company should pay, from the date of such default, interest on such amount, at the rate of 12% per annum.

(6) **Claim to company –** Any person claiming to be entitled to any money transferred to the Unpaid Dividend Account of the company may apply to the company for payment of the money claimed.

(7) **Transfer to Investor education and protection fund** – Any money transferred to the Unpaid Dividend Account of a company which remains **unpaid or unclaimed for a period of 7 years** from the date of such transfer should be transferred by the company along with interest accrued, if any, thereon to the Fund "Investor Education and Protection Fund" established section 125.

(8) **Statement of such transfer –** The company should send a statement in the prescribed form of the details of such transfer to the authority which administers the said Fund and that authority should issue a receipt to the company as evidence of such transfer.

(9) **Transfer of Share –** All shares in respect of which unpaid or unclaimed dividend has been transferred to "Investor Education and Protection Fund" should also be transferred by the company in the name of Investor Education and Protection Fund along with a statement containing such details as may be prescribed:

Provided that any claimant of shares transferred above should be entitled to claim the transfer of shares from Investor Education and Protection Fund in accordance with such procedure and on submission of such documents as may be prescribed.

(10) **Punishment for failure to distribute dividend** – If a company fails to comply with any of the requirements of this section,

Liability for	**Fine**
Company	not be less than 5,00,000 but which may extend to Rs.25,00,000
Every officer of the company who is in default	not be less than Rs.1,00,000 but which may extend to Rs.5,00,000.

CASH FLOW STATEMENT

1. Introduction

- Cash flow Statement (CFS) is an *additional information* provided to the users of accounts in the form of an statement, which reflects the various sources from where cash was generated (inflow of cash) by an enterprise during the relevant accounting year and how these inflows were utilized (outflow of cash) by the enterprise.
- Cashflows explain the cash movements between two points of time.
- Any transaction, which *does not result in cash flow*, should not be reported.

E.g.: Conversion of Debt into Equity, Depreciation charges, Acquisition of asset by issuing shares. Etc.

- *Movements within* cash or cash equivalents are not cash flows.
- A break-up of opening and closing cash shown as a note to cash flow statement.
- *Fundamental technique* of cash flow preparation – It is difficult to compile a summary of cash transactions from cashbooks due to the large volume of transactions. Thus, it is possible to compile such a summary by comparing financial statements at the beginning and at the end of accounting period.

2. Applicability

Applicability

- Mandatory
  - In case of Corporate - Non - SMCs
  - In case of non-corporate - Level I entities
- Not mandatory
  - In case of Corporate - SMCs
  - In case of non-corporate - Level II and Level III entities
- Exempted
  - **Small Company** -A private company with a maximum paid up capital of Rs. 50 lakhs and a maximum turnover of Rs. 2 crores.
  - **One Person Company (OPC)** - A company which has only one single person as its member.
  - **Dormant Company** is an inactive company which is formed for some future projects or only to hold an asset and has no significant transactions.

Objective

- To identify the *historical changes* in the flow of cash & cash equivalents.
- To determine the *future requirement* of cash & cash equivalents.
- To study the *insolvency and liquidity position* of an enterprise.
- As an indicator of amount*, timing and certainty* of future cash flows.
- To check the accuracy of *past assessments* of future cash flows

- In examining the *relationship between profitability and net cash flow* and the impact of changing prices.

Benefits

- Identifies cash generated from trading operations.
- The operating cash surplus which can be applied for investment in fixed assets.
- Portion of cash from operations is used to pay dividend and tax and the other portion is ploughed back.
- Very useful tool of planning

Cash And Cash Equivalents

Cash	**Cash equivalents**
Cash in hand	Short term highly liquid investments that are readily convertible into known amounts of cash and which are subject to insignificant risks of changes in value.
Demand deposits with bank (e.g savings/current account)	Securities with short period of say, three months or less.
	Short term deposits (less than 3 months) Preference shares bought near maturity.

3. Types Of Cash Flow

Classification of cash flow activities

- **Operating cash flows**
  - Generated by Operating activities. ie. the principal revenue-producing activities .
  - Eg. cash purchase and sale of goods, collections from customers ,payment to suppliers, payment of salaries, wages etc.
- **Investing cash flows**
  - Generated by Investing activities. ie. Acquisition and disposal of long-term assets and other investments not included in cash equivalents.
  - Eg. Receipts from disposals of fixed assets; loan given to / recovered from other entities etc.
- **Financing cash flows**
  - Generated by financing activities. ie. activities that result in changes in the size and composition of the owners' capital and borrowings of the enterprise. Eg. Issue of shares / debentures, redemption of debentures / preference shares etc.

Cash flow type depends on the business of the enterprise and other factors.
For example, since principal business of financial enterprises consists of borrowing, lending and investing, loans given, and interests earned are operating cash flows for financial enterprises and investing cash flows for other enterprises.

Method of computing

- Direct method
  - Gross receipts and gross cash payments are obtained from the accounting records to ascertain cash flows from operating activities
- Indirect method
  - The net cash from operating activities is determined by adjusting net profit or loss instead of individual items appearing in the profit and loss account

1. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method and is, therefore, considered more appropriate than the indirect method.
2. Direct method adjusts individual items of profit and loss account and indirect method adjusts overall net profit (or loss) to determine cash from operation.
3. However, indirect method of determining the cash from operating activities is more popular in actual practice.
4. Cash flow from Financing activities and Investing activities are computed in the same manner under both the methods.

Format for Cash Flow from Operating activities under Direct method

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

Format for Cash Flow from Operating activities under Indirect method

Particulars	Amount	Amount
Net Profit for the year		xxx
Add: Non-Cash and Non-Operating Expenses:	xxx	
Depreciation	xxx	
Loss on Sale of Assets	xxx	
Provision for taxation, etc.	xxx	
Less: Non-Cash and Non-Operating Incomes:		

Profit on Sale of Assets		
Net Profit after Adjustment for Non-Cash Items	xxx	(xxx)
Cash from operation Net Profit (after adjustment for Non-cash Items) (-) Increase in Current Assets (-) Decrease in Current Liability (+) Decrease in Current Asset (+) Increase in Current Liabilities Cash flow from Operating activities	 xxx xxx xxx xxx xxx	 Xxx

CLASSIFICATION OF BUSINESS ACTIVITIES

Operating	**Investing**	**Financing**
Inflows		
1.Cash sales 2.Cash from fees, commission and other income 3.Cash received from debtors	1. Proceeds from sale of fixed assets 2. Proceeds from sale of non-current assets 3.Interest received on debentures 4. Dividend received on shares	1. Proceeds from issue of shares / debentures 2. Loan raised (both long term and short term) 3.Increase in bank overdraft or cash credit
Outflows		
1. Cash purchases 2.Cash paid for operating expenses like salaries, rent etc 3. Cash paid to creditors 4. Payment of Income tax	1. Purchase of fixed assets 2. Purchase of non-current assets	1.Payment for buy back of equity shares 2.Redemption of Preference shares/Debentures 3.Repayment of loans 4.Payment of dividend 5. Payment of Interest on loans 6. Payment of preliminary expenses 7. Decrease in bank overdraft or cash credit

Note: Profit or loss on sale of fixed asset is not operating cash flow. The entire proceeds of such transactions should be taken as cash inflow from investing activity.

Format for Cash Flow statement under Indirect method

Particulars	Amount	Amount
A. Cash flow from operating activities		
Net Profit for the year	xxx	xxx
Add: Non-Cash and Non-Operating Expenses:	xxx	
Less: Non-Cash and Non-Operating Incomes:	xxx	
Operating profit before working capital changes		xxx
Add: Decrease in current assets & Increase in current liabilities	xxx	
Less: Increase in current assets & Decrease in current liabilities	xxx	
Cash generated from operations		xxx
Less: Income tax paid (net of tax refund received)		

		(xx)
Net cash from operating activities		xxx
B. Cash flows from Investing activities		
Cash inflows from investing activities (write each of them separately)	xxx	
Less: Cash outflows from investing activities (write each of them separately)	(xx)	
Net cash from Investing activities		xxx
C. Cash flow from Financing activities		
Cash inflows from investing activities (write each of them separately)	xxx	
Less: Cash outflows from investing activities (write each of them separately)	(xxx)	
Net Cash flow from Financing activities		xxx
Net increase (or decrease) in cash and cash equivalents (A +B+C)		xxx
Add: Cash and cash equivalents in the beginning of the year		xxx
Cash and cash equivalents at the end of the year		xxx

TREATMENT OF SPECIFIC ITEMS

★ Loans/Advances given, and Interests earned

Operating CF

Operating Cash Flow

- In case of financial enterprises – when it is earned in the ordinary course of business.
- In case of non-financial enterprises - when Interest is earned from customers for late payments
- In case of all enterprises – when,
  - Advances given to employees and interests earned on them
  - Advance payments to suppliers and interests earned on them

Investing Cash Flow

- In case of all enterprises - when given to subsidiaries and interests earned on them
- In case of non-financial enterprises – any transaction other than mentioned

★ Loans/Advances taken, and Interests paid

Operating Cash Flow

- In case of financial enterprises – when it is paid in the ordinary course of business.
- In case of non-financial enterprises - when advance is taken from customers and interest paid on them
- In case of all enterprises – when,
  - Interest paid to suppliers for late payment
  - Interest taken as part of inventory cost as per AS 16

Financing Cash Flow

- In case of all enterprises – when taken from subsidiaries and interests paid on them
- In case of non-financial enterprises – any transaction other than mentioned under operating cash flow

- **Extraordinary cash flows**

- Separate disclosure by classifying them as cash flows from operating, investing or financing activities, as may be appropriate.
- Insurance claims received against loss of stock or loss of profits are **extraordinary operating cash inflows.**
- Insurance claims received against loss of fixed assets are **extraordinary investing cash inflows.**

- **Investments made and dividends earned**

Operating Cash Flow

- In case of financial enterprises - when it is earned in the ordinary course of business

Investing Cash Flow

- In case of non-financial enterprises – Generally.
- In case of all enterprises - Investments in subsidiaries and dividends earned on

Operating Cash Flow

- Tax paid on operating income
- Tax deducted at source on operating income and operating expense

Investing Cash Flow

- Tax deducted at source on Investing income e.g. Interest income

Financing cash flow

- Tax deducted at source on Financing expenditure e.g. Interest paid.

- **Interest and Dividends**

Operating Cash Flow

- In case of financial enterprises - interest paid and interest and dividends received

Investing Cash Flow

- In case of non-financial enterprises - interest and dividends received

Financing cash flow

- In case of all enterprises – Dividends paid

★ Exchange gains and losses

- The foreign currency monetary assets (e.g. balance with bank, debtors etc.) and liabilities (e.g. creditors) are initially **recognised by translating them into reporting currency** by the **rate of exchange on transaction date**.
- On the balance sheet date, these are **restated** using the rate of exchange on the balance sheet date.
- The difference in values is exchange gain/loss. The exchange gains and losses are recognised in the statement of **profit and loss**.
- The change in cash or cash equivalents due to exchange gains and losses are however not cash flows. This being so, the **net increases/decreases in cash or cash equivalents** in the cash flow statements are **stated exclusive of exchange gains and losses**.
- The resultant difference between cash and cash equivalents as per the cash flow statement and that recognised in the balance sheet is **reconciled in the note on cash flow statement**.

- **Business Purchase**

- The aggregate cash flows arising from acquisitions and disposals of subsidiaries or other business units should be presented separately and classified as cash flow from investing activities.
- The cash flows from disposal and acquisition should not be netted off.
- While taking the differences between closing and opening current assets and liabilities for computation of operating cash flows, the closing balances should be reduced by the values of current assets and liabilities taken over

- **Reporting Cash Flows on Net Basis**

- Netting of receipts and payments from investing and financing activities is forbidden by AS3. i.e. cash paid on purchase of fixed assets should not be shown net of cash realised from sale of fixed assets.

- **Exceptions to the above rule – For Financial enterprises**
  - Cash flows on acceptance and repayment of fixed deposits with a fixed maturity date
  - Cash flows on placement and withdrawal deposits from other financial enterprises
  - Cash flows on advances/loans given to customers and repayments received there from.
- **Exceptions to the above rule – For Investment companies**
  - Cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short, e.g. purchase and sale of investments
  - Cash receipts and payments on behalf of customers.

5. Disclosures

- AS 3 requires an enterprise to disclose the amount of significant cash and cash equivalent balances held by it but NOT available for its use, together with a commentary by management. This may happen for example, in case of bank balances held in other countries subject to such exchange control or other regulations that the fund is practically of no use.
- AS 3 encourages disclosure of additional information, relevant for understanding the financial position and liquidity of the enterprise together with a commentary by management. Such information may include:

    - The amount of undrawn borrowing facilities that may be available for future operating activities indicating any restrictions on the use of these facilities; and
    - The aggregate amount of cash flows required for maintaining operating capacity, e.g. additional machinery purchased to increase production.
- An enterprise should disclose, in aggregate, in respect of both acquisition and disposal of subsidiaries or other business units during the period each of the following:
    - The total purchase or disposal consideration; and
    - The portion of the purchase or disposal consideration discharged by means of cash and cash equivalents.

Buy-Back Of Securities

1. Introduction

Buy back of shares mean purchase of its own share by the company from the existing shareholders. It results in decrease of share capital of the Company. The buyback of shares is also known as **Stock Buyback** or **Repurchase of Shares**.
Sec 68 of the Companies Act, 2013 empowers a company to purchase its own shares.
There are normally two types of buyback in the stock market:

- **Open Market Route**: In this method company buys its shares directly from the market via its brokers. It is generally time taking and company repurchases its shares at current market.
- **Tender Offer**: An Investor friendly method which involves company to make tender offer to shareholders to buy back their shares at fixed date and at a fixed price (usually at a premium). The interested shareholders submit their tenders specifying whole or a portion of their holding to be bought back by the company.

Note: *The above methods are for general knowledge of the students and is not relevant for exam purpose.*

2. Objectives of Buyback

a) **To increase Earnings per share** : If there is no dilution in company's earnings, the EPS increases as the number of outstanding shares is reduced with the buyback.
b) **To Increase in Promoters holding**: Shares which are bought back are cancelled, hence the promoter holding is increased.
c) **Discourage takeover**: Since the promoter holding is increased after the buyback, it discourage others to make hostile bid to take over the company.
d) **Support Share Price**: In the case of bearish market, when the company feels that the Current market price is less than it's intrinsic value, company announces buyback to support the share price in short term.
e) **Distribute surplus cash**: Company opts for buyback when they have surplus cash and do not have alternative investment opportunity, so they give the surplus cash back to shareholders.

> The offer price of buyback is generally higher than the Current Market Price.

For Example : IT giant **Infosys** has a capital allocation policy of returning **85% of the free cash flow** (Net Operating Cash Flow less capital expenditure) to the shareholders cumulatively over 5 Year period in the form of Dividends, Share Buyback etc.

3. Buyback Tests

As per Sec 68 of the Companies Act, there are some restrictions or conditions to be fulfilled for the purpose of buyback. The three tests which needs to be complied with are :

- **Shares Outstanding Test:** Number of shares to be bought back should not exceed 25% of the Equity shares outstanding in the financial year.

> Example 1: If the shares outstanding of ABC Ltd are 2 Crores, then the number of shares which can be bought back will be : 2Cr x 25% = 50Lakhs.
> Hence company can bought back maximum of 50 Lakhs shares from this test.

- **Resource Test:** Amount to be used for buy-back of shares should not exceed 25% of the Total Paid up Share Capital **AND** free reserves of the company.

> Example 2 : Suppose ABC Ltd has Paid up Capital of ₹500 Crores, General Reserve of ₹ 100 Crores and Securities Premium Reserve of ₹ 200 Crores. Then the amount which can be used for the purpose of buyback is 25% of ₹800 Crores (500+100+200) = ₹200 Crores.
>
> let's say the buyback price is Rs 200, then the Quantum of shares which can be bought back = ₹200 Crores/ ₹200 = 1Crore shares.

> For the purpose of this test, Free reserves ***also includes*** Securities premium reserves.

- **Debt Equity Test:** The post buyback debt equity ratio should be not more than 2:1. In other words, the total debt (Both secured and unsecured) after buyback should not be more than twice the amount of paid up capital and its free reserves.

> Example 3 : Suppose ABC Ltd has debt obligations worth ₹1500 Crores, and before buy back it has equity(shareholders fund) of ₹ 900 Crores.
>
> Then the company can only afford buyback of ₹ 150 Crores of equity as post buy back equity will be ₹750 Crores which is half of Debt. (Debt equity ration of 2:1 to be maintained). Considering the same buy back price of Rs 200, company can buy back shares = ₹150 Cr/ ₹200 =75 Lakhs shares.

From Examples 1,2 and 3 above, ABC ltd can buyback 50 Lakhs shares (Lower of the three), as it satisfy all the three tests.

> A company needs to satisfy **All the three tests** for the purpose of buyback.

Buy Back Tests

- **Share Outstanding test** : Number of shares to be bought back should not exceed 25% of the Equity shares outstanding in the financial year.
- **Resource Test**:Amount to be used for buy-back of shares should not exceed 25% of the Total Paid up Share Capital **AND** free reserves of the company.
- **Debt Equity Test:** The post buyback debt equity ratio should be not more than 2:1

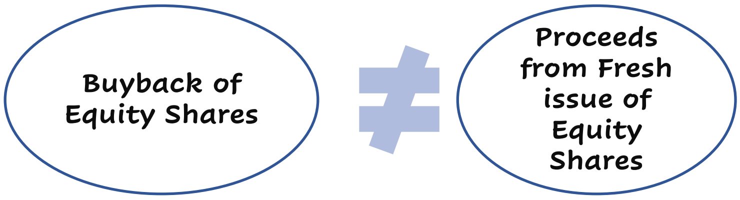
4. Resources for Buyback

As per sec 68(1) of the Companies Act, 2013 company can buyback their shares from two sources:

- Proceeds from the issue of fresh shares or any other securities.
- From existing resources.

4.1 Proceeds from Fresh Issue

In this method, company can source buyback by issuing any new shares or securities and use the proceeds out of it to pay to the shareholders.
However, **no buyback can be made** from the proceeds of the same kind of shares or securities which are to be bought back.
For Example: If XYZ ltd decides to buyback its equity shares, then XYZ Ltd **cannot use** proceeds from new issue of same equity shares for the purpose of buyback. Lets say if **preference shares are issued**, then the company is **eligible to buyback** equity shares from the proceeds of preference issue.



4.2 Using existing resources

Apart from fresh issue, company can use its free reserves, like General reserves, P&L and Securities premium reserves for the purpose of buyback.
As per Sec 69, where a company buys back its shares from free reserves or Securities Premium, a sum equal to the nominal value of shares shall **be transferred to the Capital Redemption Reserve** Account (CRR) and it should be disclosed in the balance sheet.

One thing to note here Is that the requirement of creation of CRR occurs **only when** the company is **using existing resources to source buyback**. When the company is using proceeds from the fresh issue, the requirement of creation of CRR **does not exists**.

The amount lying in CRR Account cannot be used for the purpose of payment of dividend and **can only be used** for the purpose of issue of **bonus shares**.

5. Other Provisions related to Buy-back

The other important provisions related to buyback are:

Example : Suppose Company is buying back its equity shares worth 200 Crores, out of which 50 Crores is sourced from the proceeds of fresh issue and balance 150 Crores will be utilised from General Reserve, let's say.

In this case, the amount to be transferred to CRR Account will be only 150 Crores and it is only used from existing resources.

Journal Entry to be passed :

General Reserve A/c Dr 150 Cr

To Capital Redemption Reserve A/c 150 Cr

- The shares which are to be bought back should be **fully paid up**.
- The buyback should be **authorised by articles** of the company and should be accompanied by passing of **special resolution** in general meeting of the company. However, if the buyback is **Upto 10% of paid up equity and free reserves**, then the authorisation of **board resolution** will suffice for the purpose of buyback.
- The buyback cannot be made within a period of one year from the date of closure of last buyback. In other words, there **cannot be more than one buyback in any given year**.
- Buyback shall be completed **within one year** from the passing of special resolution.
- The securities which are bought back should be **physically destroyed within seven days** from the last date of completion.

Face Value of shares Boughtback − Face value of shares issued for buyback = **CRR to be created**

6. Summary

Buy Back Tests

- **Share Outstanding test** : Number of shares to be bought back should not exceed 25% of the Equity shares outstanding in the financial year.
- **Resource Test**:Amount to be used for buy-back of shares should not exceed 25% of the Total Paid up Share Capital **AND** free reserves of the company.
- **Debt Equity Test:** The post buyback debt equity ratio should be not more than 2:1

ACCOUNTING FOR BRANCHES INCLUDING FOREIGN BRANCHES

1 Introduction

1.1 Branch

Establishment at location different from head office to carry either same or substantially same activity as carried on by head office.

Classification of Branches

- Classification of Branches
  - Inland/Domestic Branches
    - Dependent Branches
    - Independent Branches
  - International/Foreign Branches

➢ **Dependent Branches –** whole accounting records are kept at Head office
Head office will decide the branch operations, for example:

- To sell goods at specific
- Money is to be paid back to head office as soon as the goods are sold
- To sell the goods sent by head office only
- **Independent Branches –** maintain independent accounting records. Branch office will decide their own operations, For eg:
- At which Price?
- Where to Buy?
- From whom to raise loan?

1.2 Methods of charging Goods to branches

Goods are transferred from HO to branches, accounting of the same as following methods

- Methods (maintaining accounts of Dependent Branch)
  - Goods invoiced at wholesale price
    - Wholesale method
  - Goods invoiced at cost or selling price
    - Debtors method
    - Stock and debtors method
    - Trading profit and loss method

1.3 Distinguish between Branch accounts and Departmental accounts

Branch accounts
- Based on Location
- Brach reconciliation
- Foriegn exchange due to international branches
- Maintenance of accounts either by Branch or Head office
- As Expenses of each branch identifiable, No problem of apportion

Departmental accounts
- Based on Funtion
- No Concept of reconciliation
- No concept of Foriegn exchange
- Maintenance of account at one place only
- Common expense are distributed among the departments on concerned basis

2 Accounting for Dependent Branch

2.1 When goods are invoiced at cost

When Goods are transferred at cost, from Head Office to Branch office.

Debtors Method
- Suitable for small sized branches
- Separate Branch account is maintained for each branch to compute profit or loss made by each branch.

Proforma Branch account

Particulars	Amount	Particulars	Amount
To Opening balance b/d: Furniture Stock Cash Debtors Prepaid Expenses To goods sent to branch To Bank A/c Salaries Rent Sundry Expense To Profit & Loss – Profit (If credit side is larger)		By Bank A/c (Cash remitted) By Return to H.O By Balance c/d Cash Stock Debtors Petty cash Fixed Assets Prepaid Expense By Profit & Loss – Loss (If Debit side is larger)	

Under Debtors method

Head office knows

Position at the beginning of the year

Transactions involving head office during the year

Position at the end of the year

Note:
- Transactions happened in Branch, which involves Head office – will be recorded in the books of H.O in Branch account

<u>Collection on account of sales</u>
(Amount remitted to H.O by Branch)

- Cash sales
- Collection from Debtors

Recorded in the books of H.O

> Cash sales - Remitted to H.O
> Expenses directly paid by H.O
> Goods/Cash sent to Branch from H.O
> Cash remitted to H.O by Branch, but received by H.O
> Cash remitted to H.O, but not received by H.O, as Cash-in-transit
> Opening & Closing Balance of Assets

Not recorded in the books of H.O

> Cash sales - not transfered to H.O
> Expenses paid by Branch
> Credit Sales
> Good returns from customer
> Bad debts
> Discount to customer

<u>Trading Profit and loss method (Final Accounts method)</u>

- In this method, Trading and profit & loss account are prepared considering each branch as separate entity
- Branch Trading and profit & loss account is merely a memorandum account and therefore, the entries made à do not have double entry effect.

Branch Trading and profit & loss account Proforma

Particulars	Amount	Particulars	Amount
To Opening Stock To goods sent from HO Less: Returns from HO To Gross profit c/d (If credit side is larger)		By Sales: Cash Credit Less: returns By Closing Stock By Gross loss c/d (If debit side is larger)	
By Gross loss b/d To Salaries & wages To Rent & Rates To Sundry Exp. To Petty cash Exp. To Allowance to Customers To Discount To Bad debts To Net Profit (If credit side is larger)		By Gross profit b/d By Net Loss (If debit side is larger)	

Stock and debtors' method

Debtors Method → Stock and Debtors Method ← Trading Profit and loss method

Following accounts are maintained by HO under this method

Branch Debtors Account	•To get Closing balance of debtors
Branch Stock Account or Branch Trading Account	•To find Shortage or Surplus
Branch Expense Account	•To know the total of Branch expenses
Goods sent to Branch Account	•To know the cost of Goods sent by H.O to Branch
Branch Cash/Bank Account	•To know about cash flow at branch
Branch Fixed Asset Account	•Control over branch Fixed asset
Branch P&L Account	•To find Branch Net profit/loss

The manner in which entries are recorded in the above method is shown below:

Transaction	Entry
Cost of Goods sent by HO to branch	Branch Stock a/c Dr To Goods sent to branch a/c
Cost of Goods Returned from branch to HO	Goods sent to branch a/c Dr To Branch Stock a/c
Cash sales	Bank or Branch Cash a/c Dr To Branch stock a/c
Credit sales	Branch debtor a/c Dr To Branch stock a/c
Goods returned from Customer to Branch	Branch Stock a/c Dr To Branch Debtor a/c
Cost of Goods lost	Goods lost a/c Dr To Branch Stock a/c Branch P&L a/c Dr To Goods lost
Remittance for expense	Branch cash a/c Dr To Cash a/c
Any asset (Eg: Furniture) provided by HO	Branch Asset (Furniture) a/c Dr To Asset a/c
Cash paid by debtors	Branch cash a/c Dr To Branch Debtor a/c
Discount & allowance to debtors, bad debts	Branch Expense a/c Dr To Branch Debtors a/c
Remittance to HO	Cash a/c Dr To Branch Cash a/c
Branch expense directly paid by HO	Branch Expense a/c Dr To cash a/c
Expense met by Branch	Branch Expense a/c Dr To Branch cash a/c

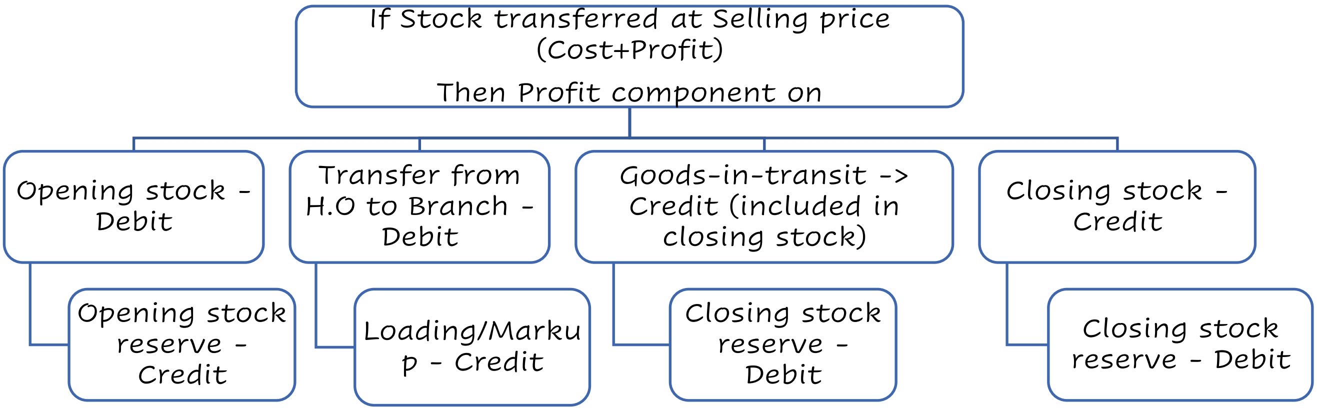
Note:
- The profits would be same in all three methods.
- If HO incurs expenses and all cash is remitted, it would be a question of dependant Branch accounting. Look for hints in question.

2.2 When goods are invoiced at Selling price

When goods transferred at Selling price (cost + profit @Mark-up), from HO to Branch

Debtors Method

Under Debtors method, if goods are transferred at selling price Then in Branch accounts	
Profit component in debit item	Credit the profit component
Profit component in credit item	Debit the profit component



Note:
- For Eg: Rs.20 profit included in the opening stock Rs.120 & Rs.50 profit included in the closing stock

Branch account

Particulars	Amount	Particulars	Amount
To Opening stock	120	By Opening stock reserve (Profit on opening stock)	20
To Closing stock reserve (Profit on Closing stock)	50	By Closing Stock	250

- Profit component on Transfer/sales by HO to branch - Loading/Mark-up
- Profit component on Transfer/sales by branch to customer - Profit of Branch

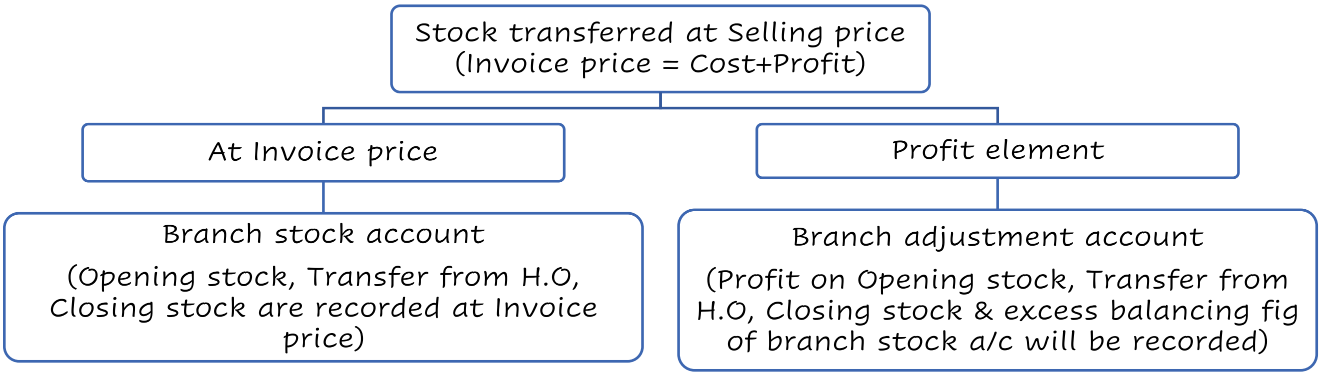
Trading Profit and loss method (Final Accounts method)

- All items of Memorandum Branch Trading and Profit and loss account are to be converted into cost price if the goods are invoiced to branch at selling price.
- Remaining will be same as if goods are invoiced at cost.

Stock and debtors' method

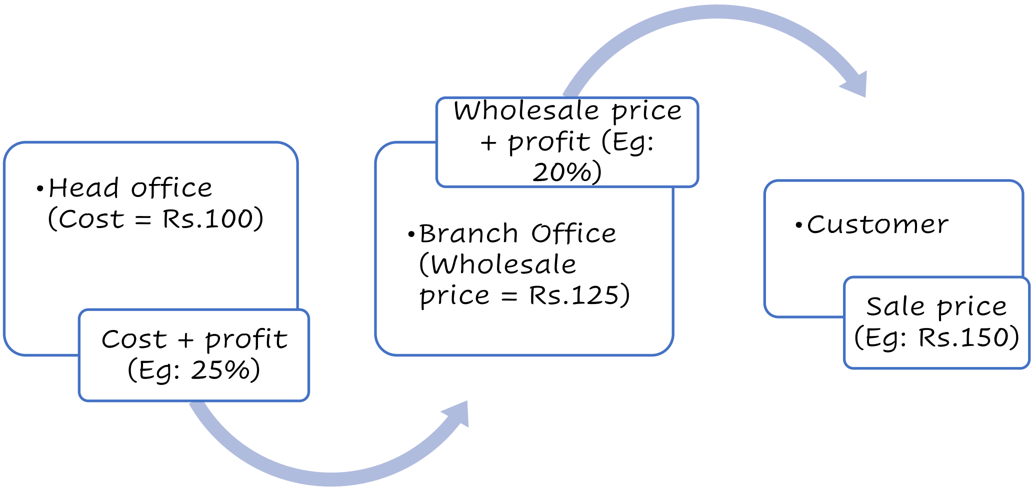
Accounts maintained under Stock and debtors' method

- Stock Account
- Debtors Account
- Profit and Loss Account & Other Account



Transaction	Journal Entry	Debit	Credit
Goods sent by HO to branch at Invoice price (Cost 100 + Profit 10 = 110)	Branch Stock a/c Dr To Branch Adjustment a/c To Goods sent to branch a/c	110	 10 100
Goods Returned from branch to HO	Branch Adjustment a/c Dr Goods sent to branch a/c Dr To Branch Stock a/c	10 100	 110
Goods lost at Invoice price (Cost 100 + Profit 10 = 110)	Goods lost a/c Dr Branch Adjustment a/c Dr To Branch Stock a/c	100 10	 110
	Branch P&L a/c Dr To Goods lost	100	 100

2.3 Wholesale Branch method



➢ $Profit\ of\ Branch = (Sale\ proceeds\ at\ shop - Wholesale\ Price\ of\ goods\ sold)$

Principles for accounting under wholesale branch method

Opening stock & Goods sent to branch will be debited to Branch Stock or Trading account @ Wholesale price

Sales, Closing stock & Goods lost will be credit to to Branch Stock or Trading account @ Wholesale price

Branch Stock or Trading account will reveal the Gross Profit or Loss --> transfer to Branch P&L

After debited with expense, Branch P&L will disclose Net profit/Loss

As Closing stock valued @ wholesale price,

Create Stock reserve --> Difference between Wholesale price and its cost

> By debiting to HO P&L

> Stock reserve carried forward to next year and then transfer to credit of HO P&L

3 Accounting in the Books of Independent Branch

3.1 Salient features of accounting system of an independent system are as follows:

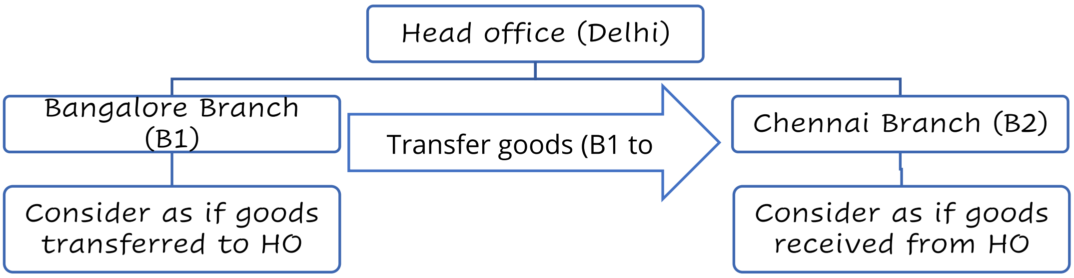
- Branch accounting - Double entry system
- Record all transaction between Branch and HO
  - Branch account in Head Office books &
  - Head office in Branch account
- Branch prepares its
  - Trail balance and profit and loss account at the end of the accounting period and
  - sends copies of these statements to HO for incorporation
- After receiving the final statement from branch, HO reconciles between
  - Branch account in HO books &
  - Head office in Branch account
- HO passes necessary journal entries to incorporate branch trail balance in its books

3.2 Journal entries

Transaction	Journal Entry in books of HO	Journal Entry in books of Branch
HO sent goods to Branch	Branch office a/c Dr To Goods sent to branch a/c	Goods received from HO a/c Dr To Head office a/c
Goods returned from branch to HO	Goods sent to branch a/c Dr To Branch office a/c	HO a/c Dr To Goods received from HO a/c
Branch pay its Expenses	No Entry	BO Expense a/c Dr To Cash/Bank a/c
Branch expense paid by HO	Branch a/c Dr To Bank a/c	Branch Expense a/c Dr To HO a/c
Branch made outside purchases	No Entry	Purchases a/c Dr To Cash/Bank a/c To Creditor a/c
Branch sales	No Entry	Cash/Bank a/c Dr Debtor a/c Dr To Sales a/c
Branch collected from Debtors	No Entry	Cash/Bank a/c Dr To Debtors a/c

Transaction	Journal Entry in books of HO	Journal Entry in books of Branch
Branch debtors collection made by HO	Cash/Bank a/c Dr To Branch a/c	HO a/c Dr To Debtors a/c
Payment made by Branch to Creditors for goods purchased	No Entry	Creditors a/c Dr To Cash/Bank a/c
Payment made by HO to Branch creditor	Branch a/c Dr To Cash/Bank a/c	Creditors a/c Dr To HO a/c
Purchase of Assets by Branch	No Entry	Asset a/c Dr To Cash/Bank a/c
Purchase of Assets for Branch, payment by HO	Branch a/c Dr To Cash/Bank a/c	Asset a/c Dr To HO a/c
Depreciation Entry for the above asset		Depreciation a/c Dr To Asset a/c P&L a/c Dr To Depreciation a/c
Asset purchased by Branch & retained in HO books	Asset a/c Dr To Branch a/c	HO a/c Dr To Cash/Bank a/c
Depreciation Entry for the retained asset	Branch a/c Dr To Asset a/c	Depreciation a/c Dr To HO a/c
Funds remittance by branch to HO	Cash/Bank a/c Dr To Branch a/c	HO a/c Dr To Cash/Bank a/c
Funds remittance by HO to branch	Branch a/c Dr To Cash/Bank a/c	Cash/Bank a/c Dr To HO a/c

3.3 Inter Branch transfer of Goods



Journal Entry in books of B1	Journal Entry in books of HO	Journal Entry in books of B2
Delhi HO a/c Dr To Goods sent to Delhi a/c	Goods from branch a/c Dr To Bangalore Branch a/c	No Entry
No Entry	Chennai branch a/c Dr Goods sent to Branch a/c	Goods from HO a/c Dr To HO a/c

3.4 Goods-in-transit & Cash-in-transit

Steps to be considered for Goods-in-transit:

1. Check whether number of HO & Branch being compared/reconciled have a common base (i.e., Either it can be Invoice price or cost to HO)
2. Example:

Head Office
- Recorded Rs.1,00,000 fully

Goods-in-transit
- Transferred goods worth Invoice price of Rs.1,00,000
- Goods-in-transit Rs. 10,000 (Rs.1,00,000 - Rs.90,000)

Branch Office
- Recorded only Rs.90,000
- Diff Rs.10,000 will be recorded as goods-in-transit to reconcile with HO

Goods-in-transit	Journal entry in HO	Journal entry in Branch
Goods-in-transit from HO to Branch	Already journal entry passed	Goods-in-transit a/c Dr To HO a/c
Goods-in-transit from Branch to HO	Goods-in-transit a/c Dr To Branch office a/c	Already journal entry passed
Cash-in-transit	**Journal entry in HO**	**Journal entry in Branch**
Cash-in-transit from HO to Branch	Already journal entry passed	Cash-in-transit a/c Dr To HO a/c
Cash-in-transit from Branch to HO	Cash-in-transit a/c Dr To Branch office a/c	Already journal entry passed

4 Incorporation of balances in HO

Journal entries in the books of HO and Branch for incorporation of balances in HO

Particulars	Journal entry in HO	Journal entry in Branch
Asset transferred from Branch to HO	Assets a/c Dr To BO a/c	HO a/c Dr To Assets a/c
Liabilities transferred from Branch to HO	BO a/c Dr To Liabilities a/c	Liabilities a/c Dr To HO a/c
Expenses transferred from Branch to HO	Expenses a/c Dr To BO a/c	HO a/c Dr To Expenses a/c
Sales transferred from Branch to HO	BO a/c Dr To Sales a/c	Sales a/c Dr To HO a/c

5 Foreign Branches

5.1 Foreign Operation

Foreign Operations

Integral Foreign Operations
- Similiar to Dependent Branch
- Largely under active control of the head ofice

Non-Integral Foreign Operations
- Similiar to Independant branch
- It figures out things on its own

5.2 Integral Operations

Principles for translating Integral Foreign Operations:

- Take the Trail Balance Foreign Operation/Branch which Foreign currency is denominated and tallied (Generally given in the question)

- Convert those number into local currency using the following conversion rates

S.No	Particulars	Conversion rates
1	Opening stock	Opening rate
2	Closing stock; all monetary items	Closing rate
3	Purchases; Sales etc	Average rate
4	Fixed assets	Actual

- Exchange difference in Trail balance à Transferred to P&L account

Exchange difference on Foreign translation

Debit side	Credit side
Loss on foreign exchange translation	Gain on foreign exchange translation
Loss should be debited to P&L	Gain should be credited to P&L

5.3 Non-Integral Foreign Operations

Principles for translating Non-Integral Foreign Operations:

- Convert those number into local currency using the following conversion rates

S.No	Particulars	Conversion rates
1	All balance sheet items	Closing rate
2	All P&L items	Actual rate/Average rate

- Exchange difference in Trail balance à Transferred to Foreign Currency Translation Reserve (FCTR)

Note:

FCTR balance will be carried forward in the balance sheet till the concerned branch operations are shutdown/closed.

Amalgamation of Companies

1. Introduction

Amalgamation refers to combination of two or more companies into a single entity. It also includes purchase of one company by the other. The company which is sold is called **Selling/Transferor/ Vendor** company and company which bought is referred as **Purchasing/Transferee/Vendee** Company.

There are three terms which should be understood by students clearly:

- **Amalgamation**: Two companies wound up and a new company is formed to take over the business. For example: India's **Maruti** Udyog Limited amalgamated with **Suzuki** Motor Corporation based in Japan to form the new entity – **Maruti Suzuki.**
- **Absorption :** An existing company takes over the business of one or more existing companies. For example : In order to dominate messaging on web, **Facebook acquired WhatsApp** for $19 billion on February 2014.
- **External Reconstruction :** A newly formed company takes over the business of existing company. In other words, it refers to winding up of an existing company and registering itself into a new one after a **rearrangement of its financial position.**

2. Objectives of Amalgamation

Some of the objectives of amalgamation are :

- To achieve economies of scale.
- To eliminate competition in the market.
- To take opportunities for future growth and development.
- Sometimes companies also amalgamate to avail certain kind of benefits in tax exemptions.
- Both company enjoy synergy benefits.
- To increase customer base and expand their business.

3. Types of Amalgamation

As per AS 14 on "Accounting for Amalgamation", there are two types of amalgamation:

a) **Amalgamation in the nature of Merger**:
It results in genuine pooling of not only assets and liabilities but also the shareholders interest and of the business of the companies. Accounting is done by pooling of interest method.

Conditions to be satisfied (All must be satisfied as per AS 14)

i. All the **assets and liabilities** of the transferor company become the assets, and liabilities of the **transferee company**.
ii. Shareholders holding **not less than 90%** of the face value of the equity shares of the transferor company become equity shareholders of the **transferee company**.
iii. The consideration for the amalgamation receivable by equity shareholders of the transferor is discharged by the transferee company **wholly by the issue of equity shares** in the transferee company (Cash may be paid for fractional share)
iv. The business of the transferor company is **intended to be carried** on, after the amalgamation, by the transferee company.
v. **No adjustment** is intended to be made to the **book values** of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

b) However, if any of the conditions are not met, then such amalgamation is called **Amalgamation in the nature of purchase.**

All 5 conditions, given below should be satisfied to classify as amalgamation in the nature of merger.

4. Purchase Consideration

As per AS 14, Purchase consideration is defined as

- "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.

In other words, it is the price payable by the transferee company to the owner's of transferor company for taking over their business.

For Example: When Facebook(transferee company) acquired WhatsApp(transferor company) for $19 Billion, the $19 billion is nothing but **the purchase consideration which is paid by Facebook to the shareholders of the WhatsApp** for taking over their business.

Amount paid towards the equity and preference shareholders is considered as part of purchase consideration. Even if debentures issued to equity shareholders are part of purchased consideration.

Any sum paid by transferee company towards creditors or debenture holders of the transferor company, that sum **will not be included** in the purchase consideration

Purchase Consideration

What is included: Sum paid towards equity and preference shareholders	**What is not included:** Any sum paid other than to equity or preference shareholders.

The purchase consideration can be computed in the following methods:

a) **Lumpsum method**: Under this method, the transferee company pays a **lumpsum/fixed amount** to shareholders of the transferor company.

b) **Net Payment method:** Under this method, purchase consideration is the claim paid to equity and preference shareholders in the **form of issue of shares, debentures or by way of cash or any other assets.**
However, it does not include any payment made to debenture holders or creditors.

c) **Net Assets method :** Under this method, the purchase consideration is taken as **Net assets of the transferor company**.

Total Assets − Outside Liabilities = **Net Assets**

The value of assets and liabilities **shall be agreed** between two parties. In case there is no agreed upon values, **the book value** of assets and liabilities shall be taken under this method.

Assets to include:

- ✓ Cash in hand and at bank, unless otherwise stated
- ✓ Goodwill or pre-paid expenses, unless otherwise stated

Assets not to include:

- × Assets not taken over
- × Fictitious assets like preliminary expenses, underwriting commission, discount on issue of shares or debentures, profit and loss account (debit balance), etc.

Liabilities to include:

- ✓ Liabilities to third parties only (and NOT to shareholders)
- ✓ Any fund or portion thereof that denotes liability to third parties e.g.: staff provident fund, workmen's' savings bank account, workmen's profit sharing fund, workmen's' compensation fund (up to the amount of claim, if any), etc.

Liabilities not to include:

- × Liabilities not taken over
- × Past accumulated profits or reserves, such as general reserve, reserve fund, sinking fund, dividend equalization fund, capital reserve, securities premium account, capital redemption reserve account, profit and loss account etc.

Few important points to be kept in mind:

1. The term total assets **does not include fictitious assets** like Debit balance of P&L account, preliminary expenses, discount on issue of shares.
2. The term outside liabilities means all liabilities **payable to third parties** such as creditors, bills payable, bank overdraft etc and will also **include fund that denotes liability to third parties** like workmen compensation fund, staff provident fund etc. This will **not include share capital** and **reserves.**
3. Goodwill, prepaid expenses and cash and bank balance also has to be **included in assets unless otherwise stated.**

Intrinsic value or share exchange method: Under this method, the purchase consideration is calculated at the intrinsic value of shares of the transferor or transferee company.

Consideration is ascertained on the **basis of the ratio** in which the shares of the transferee company are to be exchanged for the shares of the transferor company.

The ratio of shares is found out by number of shares to be received by transferor company divided by existing shares of transferor company.

Asset available to equity shareholders ÷ Number of equity shares = **Intrinsic Value**

Paid to	**Form of payment**	**Amount**
Equity Shareholders	Cash	
Preference Shareholders	Shares	
	Debentures	

5. Methods for Accounting

There are two main methods of accounting for amalgamation :

Method of Accounting for Amalgamation

- Pooling of Interest method
- Purchase method

5.1 Pooling of interest method: This method is used in case of amalgamation in the **nature of merger**.

Under this method, the **assets ,liabilities and reserves** of transferor company will be taken by the transferee company at carrying amount (book values only) unless there is adjustment due to different accounting policies.

The difference between share capital issued by transferee company and share capital of transferor company is to be **adjusted against reserves of transferee** company.

Share Capital issued + Any other consideration by transferee company − Share Capital in the books of transferor company = **Amount to be adjusted from the Reserves**

Treatment of Reserves : In th amalgamation in the nature of merger,the **identity of reserves is preserved** and they will appear in the books of transferee company in the same form in which they appear in the books of transferor company.
For Example: There is General reserve of Rs 100 Cr in the books of transferor company and the same is Rs 250 Cr in the books of transferee company.
Then during amalgamation, the general reserve of 100 Cr of transferor company will become general reserve of transferee company and will be shown as combined value of Rs 350 Cr.
5.2 Purchase method: This method is used in case of amalgamtion in the **nature of purchase.**
Under this method,the assets and liabilities are incorporated at their existing carrying amounts or at the agreed upon values.

The difference between purchase consideration and net assets should be recognised as **goodwill or capital reserve** as the case may be, in the financial statements of the transferee company.

Transfer to:

- Goodwill, if Purchase consideration> Net Assets
- Capital Reserve, if Purchase consideration<Net Assets

Treatment of Reserve: In the amalgamation in the nature of purchase, **no reserves other than statutory reserves** of the transferor company should be incorporated in the financial statements of the transferee company.
Statutory reserves like Export profit reserves, Investment allowance reserve etc are maintained for tax benefits.
In other words, the identity of reserves except statutory reserves is not preserved.
The statutory reserves retains their identity in the financial statements of the transferee company in the same form In which they appeared in the financial statements of transferor company as long as the relevant act requires to be maintained.

A **temporary** account called **Amalgamation Adjustment reserve** is debited to bring in the statutory reserves and is represented as **deduction from the reserves** as a **separate line item** of the transferee company after amalgamation.

The journal entry for incorporation of statutory reserves is:

Amalgamation Adjustment Reserve A/c   Dr
    To Statutory Reserves A/c

After the time period as per requirement of law is over, both the reserve and amalgamation Adjustment reserve Account **gets reversed**.

6. Disclosure Requirements

For all amalgamations, the following disclosures are considered appropriate in the first financial statements following the amalgamation:

a) Names and general nature of business of the amalgamating companies
b) Effective date of amalgamation for accounting purposes.
c) The method of accounting used to reflect the amalgamation; and
d) Particulars of the scheme sanctioned under a statute.

Additional requirements for amalgamation in the **nature of merger** (pooling of interest method):

a) description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation.
b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

Additional requirements for amalgamation in the **nature of Purchase** (purchase method):

a) consideration for the amalgamation and a description of the consideration paid or contingently payable; and
b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortisation of any goodwill arising on amalgamation.

Common Disclosures:
- Names and general nature of business.
- Effective date of amalgamtion.
- Method of accounting used to reflect amalgamation.
- Particulars of scheme sanctioned under statute.

7. Summary

Amalgamation in the nature of merger:
- Transfer of all assets and liabilities.
- Shareholders holding not less than 90% of face value become shareholders in transferee company.
- Purchase consideration discharged wholly by issue of equity shares except cash for fractional shares.
- Business is intended to be carried on by the transferee company.
- No adjustment is intended to be made in the book value of assets and liabilities except to ensure uniformity of accounting policies.

Methods to compute purchase Consideration:

a) **Lumpsum method**: Under this method, the transferee company pays a **lumpsum/fixed amount** to shareholders of the transferor company.

b) **Net Payment method:** Under this method, purchase consideration is the claim paid to equity and preference shareholders in the **form of issue of shares, debentures or by way of cash or any other assets.**
However, it does not include any payment made to debenture holders or creditors.

c) **Net Assets method :** Under this method, the purchase consideration is taken as **Net assets of the transferor company**.

Total Assets − Outside Liabilities = **Net Assets**

d) **Intrinsic value or share exchange method:** Under this method, the purchase consideration is calculated at the intrinsic value of shares of the transferor or transferee company.

Asset available to equity shareholders ÷ Number of equity shares = **Intrinsic Value**

Amalgamation in the nature of Merger :

Share Capital issued + Any other consideration by transferee company − Share Capital in the books of transferor company = **Amount to be adjusted from the Reserves**

Treatment of Reserves : In th amalgamation in the nature of merger,the **identity of reserves is preserved** and they will apear in the books of transferee company in the same form in which they appear in the books of transferor company.

Purchase Method: The assets and liabilities are incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual assets and liabilities on the basis of their fair values at the date of amalgamation.

Transfer to:

- Goodwill, if Purchase consideration> Net Assets
- Capital Reserve, if Purchase consideration<Net Assets

Treatment of Reserve: In the amalgamation in the nature of purchase, **no reserves other than statutory reserves** of the transferor company should be incorporated in the financial statements of the transferee company.

A **temporary** account called **Amalgamation Adjustment reserve** is debited to bring in the statutory reserves and is represented as **deduction from the reserves** as a **separate line item** of the transferee company after amalgamation

A. ENTRIES IN THE BOOKS OF TRANSFEROR COMPANY (SELLER) FOR CLOSURE OF ACCOUNTS

Step I: Transfer business
Step II: Record purchase consideration
Step III: Ascertain profit / loss on transfer of business, and settle shareholders' accounts

STEP I: TRANSFER BUSINESS

1. Transfer all assets and liabilities (except cash and fictitious assets) to "Realization A/c"
   Realization A/c Dr
   To Asset A/c (at book value)

   Liabilities A/c Dr (at book value)
   To Realization A/c

2. Sale of **assets not taken over** by transferee company

   Bank A/c Dr (amount received on sale)
   To Realization A/c (since assets have already been transferred to realization a/c)

3. Settlement of **liabilities not taken over** by transferee company

   Realization A/c (since liabilities have already been transferred to realization a/c)
   To Bank A/c (amount paid on settlement)

4. **Cash** of transferor company

   (a) If cash is taken over by transferee company:
   Realization A/c Dr.
   To Cash
   All realization expenses of transferor to be incurred by transferee (since no cash is available with transferor)

   (b) If cash is not taken over:
   - Do not transfer to realization account.
   - Separately prepare cash account.
   - Transfer balancing figure in this cash account (after realization of assets not taken over, meeting all liabilities not taken over and meeting realization expenses to their account, if any) to Equity Shareholders A/c.
     Cash A/c Dr. (Balancing figure)
     To Equity Shareholders' Account

STEP II: RECORD PURCHASE CONSIDERATION

1. Purchase consideration due
   Transferee company A/c Dr
   To Realization A/c

2. Purchase consideration received
   Equity shares in Transferee company A/c Dr
   Debentures in Transferee company A/c Dr
   Cash A/c Dr
   To Transferee company A/c

3. Realization expenses

   (a) If borne by transferee – No entry required in transferor's books

   (b) If borne by transferor

   Realization A/c Dr
   To Bank A/c

   (c) If incurred by transferor and reimbursed by transferee

Transferee company A/c Dr
To Bank

Bank A/c Dr
To Transferee company A/c

STEP III: ASCERTAIN PROFIT / LOSS ON TRANSFER OF BUSINESS, SETTLE SHAREHOLDERS' A/c

1. First, close Preference Shareholders A/c

   Preference shareholders A/c Dr.
   To Preference share/ Equity share in Transferee company A/c
   To Cash A/c
   Transfer balance (excess / short payment), if any, to Realization A/c

2. Transfer Cash A/c to Equity Shareholders' A/c as mentioned in Step I above (i.e. in case cash is not taken over)

3. Transfer equity share capital, P/L balance, reserves, fictitious assets to Equity Shareholders' A/c

   Share capital A/c Dr
   Reserves A/c Dr
   To Equity Shareholders' A/c

   Equity Shareholders' A/c Dr
   To P&L Dr Bal
   To Misc. Expenses

4. Transfer balancing figure of Realization A/c to Equity Shareholders' A/c

   Realization A/c Dr
   To Equity Shareholders' A/c
   This is for profit. Reverse this entry for loss

5. Settlement of purchase consideration to Equity Shareholders

   Equity Shareholders' A/c Dr
   To Cash
   To Equity shares in Transferee company
   To Preference Shares in Transferee company
   To Debentures in Transferee company
   To Assets (If Any)

With all these entries, Equity Shareholders' A/c should tally

B. ENTRIES IN THE BOOKS OF TRANSFEREE COMPANY (BUYER)

B1. Pooling of interest method – Amalgamation in the nature of merger

1. On business amalgamation

   Business Purchase Account Dr (with amount of consideration)
   To Liquidator of Transferor Company

2. Incorporating assets, liabilities and reserves taken over from transferor company

   Sundry Assets Dr (Individually, with book value)
   To Sundry Liabilities (Individually, with book value)
   To Profit and Loss A/c (with book balance)
   To Reserves (with book balance)

To Business Purchase A/c (with amount of consideration)

- ✓ *All assets, written off expenses, debit balance of Profit and Loss Account, outside liabilities and reserves of the transferor company have to be recorded in the books of the transferee company in the form and at the book values as they were appearing in the books of the transferor company on the date of amalgamation.*
- ✓ *However, if there is a conflict in accounting policies of transferee and transferor companies, changes in book values may be made to ensure uniformity.*
- ✓ *While passing the above journal entry, difference between the amount of consideration payable by the transferee company to the transferor company and the amount of the share capital of the transferor company is adjusted in the general reserve or other reserves.*

3. On payment of consideration

Liquidator of Transferor Company Dr. (with purchase consideration)
To Equity Share Capital A/c (with paid-up value of shares allotted)
To Preference Share Capital A/c (with paid-up value of shares allotted)
To Share Premium A/c
To Bank (with cash paid)

4. If liquidation expenses of transferor company are borne by transferee company

General Reserve A/c Dr. (with amount of expenses)
To Bank

5. For formation expenses of transferee company

Preliminary Expenses A/c Dr. (with amount of expenditure)
To Bank

6. On discharge of liability taken over

Debentures in Transferor Company Dr. (with paid-up value of debentures allotted)
To Debentures

B2. <u>Purchase method – Amalgamation in the nature of purchase</u>

1. On business acquisition from transferor company

Business Purchase A/c Dr. (with amount of consideration)
To Liquidator of Transferor Company

2. Taking over of assets and liabilities from transferor company

Sundry Assets A/c Dr. (Individually, excluding goodwill, at revalued figures, if any, otherwise at book values)
To Sundry Liabilities A/c (Individually, with amounts at which taken over)
To Business Purchase A/c (with amount of consideration)

Transfer balance as under:
Excess of consideration over net assets, i.e. debit goodwill
Shortfall in consideration vis-à-vis net assets i.e. credit capital reserve

3. On payment of consideration

Liquidator of Transferor Company Dr. (with amount of consideration)
To Preference Share Capital A/c (with face value of shares allotted)
To Equity Share Capital A/c (with face value of shares allotted)
To Share Premium A/c

To Debentures A/c (with face value of debentures allotted)
To Bank (with amount paid)

4. To record statutory reserves of transferor company

Amalgamation Adjustment A/c Dr
To Statutory Reserve A/c (with amount of statutory reserve)

5. If liquidation expenses of transferor company are borne by transferee company

Goodwill Account Dr.
To Bank (with amount of expenditure)

6. With formation expenses of transferee company

Preliminary Expenses A/c Dr. (with amount of expenditure)
To Bank

7. If there are both goodwill and capital reserve, Goodwill may be written off against Capital Reserve

Capital Reserve A/c Dr.
To Goodwill A/c (with amount written off)

8. If any liability is discharged by transferee company

Respective Liability A/c Dr. (with the amount payable, as the case may be)
To Share Capital A/c
To Debentures A/c
To Bank

B3. <u>Other adjustment entries in the books of transferee (BUYER)</u>

Below mentioned adjustments need to be made only after amalgamation has been recorded in the books as per either of the above method

1. Inter-company owings

Where transferor owes an amount to transferee or vice versa, it would appear as payables and receivables in their respective accounts, and would have got included in both accounts on recording amalgamation.

Accordingly, the same should be knocked off as under:

Trade Payables Dr
To Trade Receivables

2. Stock related adjustments

Inter-company owings would have arisen due to sale/ purchase of goods / services. Hence, debtor company may hold stock which was purchased from creditor company, with profit already being recorded in latter's books.

Accordingly, such profit so recorded should be eliminated and value of stock reduced as under:

Goodwill/ Capital Reserve Dr
To Stock

Internal Reconstruction

1 Introduction

When a company is facing consistent losses, the assets of the company gets overvalued and it is over capitalised. Such situation does not depict the true picture of financial statements. It brings the need for reorganising the affairs of the company.
Reconstruction is a process by which affairs of the company are reorganised by

- revaluation of assets,
- reassessment of liabilities and
- writing of losses already suffered by
- reducing paid up value of shares and/or
- varying the rights attached to different classes of shares.

In simple words, reconstruction is an internal process of cleaning up the company's balance sheet in order to show more clearer picture of company's financial position and performance.

Objective of reconstruction

Reorganise the capital or compound with creditors so that company can get out of this loss-making journey **without winding up the existing company**.

Types of Reconstruction

- Internal Reconstrution (Dealt by Companies Act 2013)
- External Reconstruction (Dealt by AS 14 on Accounting for Amalgamtion)

2 Difference between Internal and External Reconstruction

Basis	Internal Reconstruction	External Reconstruction
Liquidation	The existing company is not liquidated and there is only rearrangement.	The existing company is liquidated to form a new company.
Reduction of Capital	There is reduction of share capital and sometimes outside liability holders also have to reduce their claim or waive off.	There is no reduction of capital, instead fresh capital is brought into the new company.
Legal Compliance	Internal reconstruction is done as per provisions of Sec 61& 66 of the Companies Act 2013.	External reconstruction is done as per provisions of Sec 232 of the Companies Act 2013.
Transfer of Assets and Liabilities	There is no transfer of Assets and liabilities in case of internal Reconstruction.	Assets and Liabilities of existing company are transferred to new company.

3 Methods of Internal Reconstruction

The following methods are generally used in the process of internal reconstruction :

3.1 Alteration of Share Capital

According to Sec 61 of the companies act 2013, a limited company can alter its share capital, if authorised by articles, by passing an ordinary resolution in the general meeting.

Subdivision or Splitting of shares : The existing share capital is **sub divided into smaller denominations** with amount of remaining unaffected.

For example : A company having 10,000 shares having face value Rs 10, fully paid up, decides to split its one share of 10 Each to 10 Shares of Rs 1 each.
The journal entry would be passed as :

Equity Share Capital A/c (Rs 10) Dr. 100,000
To Equity Share Capital A/c (Rs 1) 100,000
(Being the subdivision of 10,000 shares of Rs 10 each into 100,000 Shares of Rs 1 each)

Consolidation of Shares : The existing share capital is **consolidated into higher denominations** with amount of share capital remaining same.

For example : A company having 10,000 shares having face value Rs 10, fully paid up, decides to Consolidate its 10,000 shares of 10 Each to 1000 Shares of Rs 100 each.
The journal entry would be passed as :

In real life such journal entries are not passed, there is only change in disclosure in balance sheet.

Equity Share Capital A/c (Rs 10) Dr. 100,000
To Equity Share Capital A/c (Rs 100) 100,000
(Being the Consolidation of 10,000 shares of Rs 10 each into 1000 Shares of Rs 100 each)

Conversion of Fully paid shares into Stock : According to Sec 61 of Companies Act 2013, a company can convert its fully paid shares into stock and reconversion of stock into shares. However, it should be authorised by articles of company and should be backed by passing of ordinary resolution in a general meeting.

A stock is nothing but a bundle of fully paid up shares put together which may be divided into any amount and transferred into any fraction and subdivision without regard to the original face value of share.

For example : ABC Ltd having 10,000 shares having face value Rs 10, fully paid up, decides to Convert the issued shares to stock.

The journal entry would be passed as :
Equity Share Capital A/c Dr. 100,000
To Equity Stock A/c 100,000
(Being conversion of 10,000 shares of Rs 10 each into Rs 100,000 Equity stock)

Reconversion of Stock into shares :
For example : ABC Ltd having Rs 100000 stock decides to Reconvert the stock into shares of 10 Each

The journal entry would be passed as :

Equity Stock A/c Dr. 100,000
To Equity Share Capital A/c 100,000
(Being Reconversion of Rs 100,000 Stock into 10,000 shares of Rs 10 Each)

3.2 Variation of Shareholders Rights

Sec 48 of the Companies Act 2013, provides that when a company has issued different classes of shares with differential rights or privileges attached to such shares,For example; rights as to dividend, voting rights etc. Any such rights can be alterned in any manner.
Students should note that there is no change in the amount of share capital.
For example : ABC Ltd having 9% 100,000 preference shares of Rs 10 Each decides to change the rate of dividend to 10% on those shares.

Then the following journal entry would be passed :

9% Preference shares A/c Dr 10,00,000
To 10% Preference shares A/c 10,00,000

(Being rate on 100,000 preference shares changed from 9% to 10%)

3.3 Reduction of Share Capital

Sec 66 of the Companies Act 2013 deals with reduction of share capital. Company on obtaining approval from tribunal and passing special resolution may reduce the share capital in the following manner :
This reduction is sacrifice by the shareholders and amount of reduction or sacrifice is credited to a new account called **Capital Reduction account (or Reconstruction Account)**

1) **Extinguishing or reducing the liability of the shareholders in respect of unpaid amount on shares held by them :**

In this case, the shareholders are not called to pay remaining amount on the shares held by them.

For example : XYZ Ltd having shares with face value of Rs 100 each (80 Paid up) decides to cancel the unpaid amount of Rs 20 and makes into shares with Rs 80, fully paid up.

The entry in this case would be :

Share Capital (Partly Paid up)A/c Dr Rs 80 (FV Rs 100) × No of shares
To Share Capital (Fully paid up) A/c Rs 80 (FV Rs 80) × No of shares
(Being shares of FV Rs 100 each became shares of Rs 80 each)

2) **Paying off any excess paid up share capital :**
When company is not able to use the share capital in an efficient manner, it may decide to refund the excess capital to its shareholders.
For example : XYZ Ltd having 1000 shares with face value of Rs 100 each decides to pay off Rs 80 per share to make it of Rs 80 fully paid up.
The entry in this case would be :

Share Capital Account (Rs 100) Dr 100,000
To Share Capital Account (Rs 80) 80,000
To Sundry Shareholders A/c 20,000

Sundry Shareholders A/c Dr 20,000
To Bank A/c 20,000
(Being excess capital of Rs 20 per share paid off)

3) **Cacelling any paid up shares which is lost or is unrepresented by available assets.**
Reduction in Paid up value only : In this case the nominal value of share remains same and only the paid value is reduced.
For example : ABC Ltd Shareholders decide to reduce the paid up capital of Rs 100 per share to Rs 60 per share, i.e., sacrificing Rs 40 per share
The entry in this case would be :

Share Capital A/c Dr Rs 40 × No of Shares
To Capital Reduction A/c Rs 40 × No of shares
(Being the sacrifice of Rs 40 per share having face value of Rs 100)

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

Share Capital A/c Dr Rs 100 × No of Shares
To Capital Reduction A/c Rs 40 × No of shares
To Share Capital A/c Rs 60 × No of shares
(Being the old shares of face value Rs 100 became new shares of Face value Rs 60)

3.4 Compromise/Arrangements :

A scheme of compromise and arrangement is an agreement between a company and its member and outside liabilities when the company faces financial problems.
Such arrangement also involves sacrifice by shareholders,or creditors or debentureholders or by all of them.

For example : ABC Ltd Shareholders decide to give up their right over the reserves and accumulated profits totalling to Rs 100,000.

The entry in this case would be :

Reserves A/c Dr Rs 100,000
To Capital Reduction A/c Rs 100,000
(Being shareholders decides to forego their rights on Reserves of the company)

3.5 Surrender of Shares

In this method, shares are divided into smaller denominations in order to increase the number of outstanding shares and then shareholders are called upon to **surrender their shares** to the company. Then these **shares are allotted to debenture holders or creditors** so that their liabilities are reduced.

4 Entries in Case of Internal Reconstruction

a. **Appreciation of Asset or reduction in Liability :**

Asset/Liability A/c Dr Rs XXXX
To Capital Reduction A/c Rs XXXX
(Being Appreciation in the value of asset or reduction in value of liability being transferred to Capital reduction account)

b. **Over Valuation of Assets and Debit balance in Profit and loss account** :

Capital Reduction A/c Dr Rs XXXX
General Reserve A/c (if any) Dr Rs XXXX
To Asset A/c Rs XXXX
To Profit and Loss A/c Rs XXXX
(Being Overvaluation of asset and debit balance in P&L written off)

Any debit balance in P&L Account is written off against the surplus in capital reduction account even if not specified in question.

c. **Balance appearing in Capital Reduction Account** :

Capital Reduction A/c Dr Rs XXXX
To Capital Reserve A/c Rs XXXX
(Being excess balance in capital reduction account is transferred to Capital Reserve account)

Any balance in Capital Reduction account is adjusted against general reserves of the company.

5 Summary :

Methods of Internal Reconstruction

- Alteration of Share Capital
- Variation of Shareholder's rights
- Reduction of Share capital
- Compromise/Arrangements
- Surrender of Shares

Few important points to be kept in mind by students while preparing balance sheet:

1) After the name of the company the words "**And Reduced**" should be added only if the court orders so.
2) In case of **fixed Assets,** the **amount written off** under the scheme of reconstruction must be shown for **five years**.
3) The balance in the reconstruction account to be transferred to **Capital Reserve** and should be shown under the head **Reserves and Surplus**.

1. Introduction

Consolidated financial statements are prepared to provide financial information about a parent and its subsidiaries as a **single economic entity,** thus aiding shareholders in their **decision-making process.**
As per section 129 of the Companies Act, 2013, every company having a subsidiary, associate or a joint venture is mandated to prepare consolidated financial statements.

1.1 Advantages of Consolidation

- Users can get **overall picture of the group** as it becomes a **single source document**.
- **Intrinsic share value** of the **holding company** can be calculated directly from the **Consolidated Balance Sheet**.
- The **minority interest data** in **consolidated financial statements** indicates the **amount payable to outside shareholders**, which helps in the **acquisition of a subsidiary**.
- •The **overall financial health** of the **holding company** can be judged using **consolidated financial statements**, which helps **investors and other stakeholders**.

2. Definitions

Holding Company: As per Section 2(46) of the Companies Act, 2013, "Holding company", in relation to one or more other companies, means a company of which such companies are subsidiary companies.

Subsidiary Company:

Section 2(87) of the Companies Act, 2013 defines "subsidiary company" as a company in which the holding company-
- **Controls the composition** of the Board of directors or
- **Exercises or controls more than one half of the total share capital** either at its own or together with one or more of its subsidiary companies

AS 21 - An enterprise controlled by another enterprise.

Control: 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 or governing body** to obtain **economic benefits** from its activities.

Group of Companies: The companies connected as Holding and Subsidiaries, along with associates and joint ventures are collectively called as a Group of Companies.

Upstream transaction: a transaction in which the subsidiary company sells goods to holding company.

Downstream transaction: holding company is the seller and subsidiary company is the buyer.

3. Accounting Standard 21

3.1 Scope

Deals With	Does Not Deal With
Principles and procedures for preparation and presentation of consolidated financial statements	**Methods of accounting for amalgamations** and their effects on consolidation (**covered by AS 14**)

Accounting for investments in subsidiaries in Separate Financial Statements	**Accounting for investments in Associates** (**covered by AS 23**)
	Interest in joint ventures (**covered by AS 27**)

3.2 Exclusion From Preparation Of Consolidated Financial Statements

As per **AS 21**, a **subsidiary should be excluded from consolidation** when:

• **Control is intended to be temporary**, because the subsidiary is **acquired and held exclusively with a view to its subsequent disposal in the near future**; **or**

• It **operates under severe long-term restrictions** which **affect its ability to transfer funds to the parent**.

3.3 Components Of Consolidated Financial Statements

Components Of Consolidated Financial Statements

- Consolidated Balance Sheet
- Consolidated Statement of Profit and Loss
- Consolidated Cash Flow Statement
- Notes and Statements and Explanatory Schedules

4. Consolidation Process

The various steps involved in the consolidation process;

STEP1. **Ascertain Date of Control**: Identify the date on which the parent-subsidiary relationship came into existence.

STEP2. Determine the **shareholding structure** of the subsidiary company as on the date on which the consolidated balance sheet is being prepared.

S.No	Particulars	No. Of Shares	Percentage Of Shareholding
a	Parent Company	xx	xx
b	Minority Shareholders	xx	xx
a+b	Total	XXX	XXX

STEP3. Analysis of Profits

- All **reserves and profits (or losses)** of the **subsidiary company** should be **classified into pre-acquisition and post-acquisition** reserves and profits (**subject to certain adjustments**).
- **Profits (or losses)** earned (or incurred) by the **subsidiary company up to the date of acquisition** of shares by the **holding company** are called **pre-acquisition or capital profits (or losses)**.

Particulars	Treatment
Profits / Losses earned or incurred	Profit / Losses earned or incurred by the Subsidiary company up to the date of control (ascertained in Step 1) are to be considered as pre-acquisition profits.

	Profits / losses are apportioned on a reasonable basis such as time.
Reserves	All reserves of the Subsidiary company up to the date of control (ascertained in Step 1) are to be considered as pre-acquisition / capital profits.
Revaluation of Assets and Liabilities	The surplus or deficit arising on account of revaluation should be considered and treated as Capital Profits. The corresponding depreciation on assets after the date of revaluation is to be computed and adjusted against post-acquisition profits.
Cumulative Preference Shares	In case the company has cumulative preference shares on which dividend has not been provided for, the same should be adjusted against the profits of the company
Interest on Loans and Debentures	In case interest payable on loans and debentures is not accounted in the books, the same must be adjusted against the profits of the company
Bonus Shares	In case the Subsidiary company has issued bonus shares from pre- acquisition reserves / profits, the same should be reduced from capital profits and added to the equity share capital of the same. In case bonus shares are issued out of post-acquisition profits, the same should be included as part of revenue reserves.
Proposed dividend or dividend already paid by Subsidiary	Pre-acquisition dividend: if it is being paid out of the profits earned by the Subsidiary before Holding Co. obtained control Post-Acquisition Dividend: if it is being paid out of the profits earned by the Subsidiary Co. after Holding Co. obtained control.

Proposed Dividend In The Books Of Subsidiary

Not Accounted In Books Of Subsidiary	Accounted In The Books Of Subsidiary	
	Pre-Acquisition	Post Acquisition
• No adjustments is to be made • Disclosure is required	Credit to Investment Account in the books of Holding Company	Credit to Profit and Loss A/c of the Holding Company
	Rectify errors if such dividend is credited to PL	

Dividend Paid By Subsidiary

Paid Before Date Of Control	**Paid After Date Of Control**		
	Holding Company Has Received The Dividend		Minority Dividends
	Pre-Acquisition	Post Acquisition	

to be ignored	Credit to Investment Account in the books of Holding Company	Credit to Profit and Loss A/c of the Holding Company	To be deducted from minority interest

Uniform Accounting Policies

In case certain adjustments are required for the purpose of using uniform accounting policies in the consolidation procedure, the treatment is as follows:

Difference On Account Of Changes In Subsidiary's Books For Ensuring Uniform Accounting Policies Are Followed	
For period upto date of control	For period after date of control
Adjust against pre acquisition profits/ reserves	Adjust against post acquisition profits/ reserves

Apportionment of Reserves and Profits (as analysed above)

The pre-acquisition and post-acquisition reserves and profits are then apportioned between the Parent Company and the minority shareholders in the ratio of their shareholding, as ascertained in Step 2.

Revaluation Of Assets of Subsidiary Company

Profit or loss on revaluation of fixed assets of subsidiary should be treated as capital profit or loss. But if the fall in the value of the asset occurs after the date of acquisition, the loss should be treated as revenue loss.

STEP4. Cost Of Control

The cost of investment and the equity in the subsidiary needs to be calculated on the date of investment.

Calculation Of Goodwill/Capital Reserve

Goodwill = Amount Paid (Cost of Investment) - Share of Net Assets Received (Parent's share in the equity of the subsidiary on date of investment)
Capital Reserve = Share of Net Assets Received - Amount Paid (Cost of investment)
Where,
Share of Net assets Received= Shareholder's fund on the Date of Acquisition* Percentage of Holding

Example:

If Company A acquired 60% interest in Company B, and Net Assets= 2,00,000

NET ASSETS=
Total Assets- Outside Liabilities

Minority Interest
= Controlled/ Not Owned
Here, (100-60) % of 2,00,000
=80,000

Cost of Control
= Controlled and Owned
Here, 60 % of 2,00,000
=1,20,000

STEP5. Minority Interest

Minority Interest is that part of the **net results of operations** and **net assets of a subsidiary** which are **controlled but not owned**, directly or indirectly through subsidiaries, by the **holding (parent) company**.

It is **calculated on the date of the Consolidated Balance Sheet**.

Minority Interest = Share Capital of subsidiary belonging to outsiders + Minority Interest in Reserves and Profits of Subsidiary Company

Note-

- Share of reserves can be directly computed using the closing balance
- If balance on date of acquisition and share in post acquisition profits is considered, remember to reduce dividend paid to minority shareholders.

Presentation:

• **Minority Interests** should be shown **separately** in the **Consolidated Balance Sheet**, distinct from both **liabilities** and the **equity of the parent's shareholders**.

Special Case – Negative Minority Interest:

• If **Minority Interest has a negative balance**, it **should not be shown as an asset**.

• It should be **deducted from the Profit and Loss Account** of the **Parent Company**, **unless** the minority shareholders are **legally bound and financially able** to make good the losses.

• The adjustment should be **reversed in case of subsequent profits**.

STEP6. Eliminate Inter Company Transactions

Intragroup balances and transactions and resulting unrealized profits should be **eliminated in full.**
Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.
When one enterprise in the group sells to another, and the inventory is unsold at the end of the year, the unrealised profit on sales is eliminated, and the corresponding closing stock is valued at cost.

Case	Situation	Treatment
Unrealized profit in Inventories	Where one enterprise sells goods to another in the same group, and the stock remains unsold for the buying company at the end of the year	• Unrealised profit eliminated from group profit • Closing inventory to be valued at cost • For Upstream transaction, profit should also be reduced from minority interest.
Unrealized profit on transfer of non-current asset		• Profit eliminated from consolidated financial statements
Unrealized Loss	Resulting from Intra Group Transactions that are deducted to arrive at the carrying amount	• These are eliminated unless cost cannot be recovered

Bills/Trade Receivables and Bills/ Trade Payables must be eliminated for Inter-Company transactions. If Bills Receivable doesn't exist on the balance sheet date (as in case of Discounting by Bank), Bills payable cannot be cancelled.

STEP7. Consolidated Reserves and Surplus

Balance to be shown in Consolidated Balance Sheet =
Reserves as per Holding Company's Balance Sheet
Add: Holding Company's share of post-acquisition profits and reserves
Add: Capital Reserve if any
Less: Pre acquisition Dividend
Less: Unrealised Profits

STEP8. Preparation of Consolidated Financial Statements

Consolidated Balance Sheet

	Treatment
Equity and liabilities	
Share Capital	Only that of Holding Company
Reserves	As per STEP 7
Minority Interest	
Liabilities	Holding + Subsidiary – Intragroup Transactions
Assets	
Non-Current Assets	Holding+ Subsidiary+ Adjustments Goodwill if any
Inventories	Holding+ Subsidiary- Stock Reserve
Investments	Total Outside Liabilities
Cash and Cash Equivalents	Holding+ Subsidiary

- Assets and liabilities of holding and subsidiary are merged.
- Share capital of **only Parent company** is shown in the Consolidated Balance Sheet.
- Share Capital, Reserves and investments of holding company in shares of subsidiary company are not separately shown in consolidated balance sheet.
- Instead, these are shown as (a) minority interest (b) cost of control (c) holding company's share in post-acquisition profits of the subsidiary company
- Minority Interest is shown on the liabilities side
- Cost of Control resulting in goodwill should be a part of Fixed Assets

Tax expense

While preparing consolidated financial statements, the tax expense should be the aggregate of the amounts of tax expense of the Parent and the subsidiary company. No adjustments can be made to tax expenses.

Consolidated Statement Of Profit And Loss

- All the items of profit and loss account are to be added on line by line basis
- inter-company transactions should be eliminated and
- any unrealized profit is to be eliminated from the value of inventory
- inter company dividend is also eliminated

Consolidated Cash Flow Statement

Consolidated cash flow statement is presented in case a parent presents its own cash flow statement.

5. Other Important Points

Treatment Of Subsidiary Company Having Preference Share Capital

While preparing CFS, outstanding cumulative preference shares issued by a subsidiary are **external liabilities**
Dividends should be adjusted for, whether or not profits are available or dividends have been declared (except for non-cumulative preference shares).

Alignment Of Reporting Dates

The financial statements used in the consolidation should be drawn up to **the same reporting date.** If it is not possible, adjustments should be made for the effects of significant transactions that occur between those dates.
Difference must not be more than **6 months.** The length of reporting periods and difference in reporting dates must be consistent.

6. Summary

Exclusion From Preparation Of Consolidated Finanial Statements

As per AS 21, a subsidiary should be excluded from consolidation when:

- control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future; or
- it operates under severe long-term restrictions which affects its ability to transfer funds to the parent.

The steps for consolidation are:

1. Ascertain Date of Control
2. Shareholding Pattern
3. Analysis of Profits
4. Minority Interest
5. Cost of control
6. Eliminate Intra Group Transactions
7. Consolidated Reserves
8. CFS

Consolidated Balance Sheet

	Treatment
Equity and liabilities	
Share Capital	Only that of Holding Company
Reserves	As per STEP 7
Minority Interest	
Liabilities	Holding + Subsidiary – Intragroup Transactions
Assets	
Non-Current Assets	Holding+ Subsidiary+ Adjustments Goodwill if any
Inventories	Holding+ Subsidiary- Stock Reserve
Investments	Total Outside Liabilities
Cash and Cash Equivalents	Holding+ Subsidiary

AS 23

ACCOUNTING FOR INVESTMENTS IN ASSOCIATES IN CONSOLIDATED FINANCIAL STATEMENTS

Introduction

Investor presenting consolidated financial statements should account for investments in associates as per equity method in its separate financial statements.

Definition

a. **Group** – Parent and all its subsidiaries

b. **Equity method** –
   (i) Investment is initially recorded at cost, identifying any goodwill/capital reserve arising at the time of acquisition.
   (ii) Carrying amount of investment is adjusted for the post acquisition change in the investor's share of net assets of the investee.
   (iii) The consolidated statement of profit and loss reflects the investor's share of the results of the operations of the investee.

c. **Equity –** Residual interest in the assets of an enterprise after deducting all its liabilities.

d. **Consolidated financial statements –** Financial Statements of a group presented as those of a single enterprise.

e. **Associate –** Enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.
   (i) Having 20% or more and up to 50% of the voting power or any interest directly or indirectly in any other enterprise.

f. **Significant influence –** Power to participate in the financial and/or operating policy decisions of the investee but not control over those policies.

   An enterprise can influence the significant economic decision by many ways
   (i) Having some voting power

   (ii) Representation on the board of directors or governing body of the investee
   (iii) Participation in the policy making processes.

Control exists when parent company has either

a. The ownership directly or indirectly through subsidiaries of more than one-half of the voting power of an enterprise.

b. Control of the composition of the BOD

   An enterprise is deemed to have the power to appoint a director/member, if any of the following conditions is satisfied:

   (i) A person cannot be appointed as director/member without the exercise in his favour by that enterprise of such a power as aforesaid;

   (ii) A person's appointment as director/member follows necessarily from his appointment to a position held by him in that enterprise;

   (iii) The director/member is nominated by that enterprise or a subsidiary thereof.

2.3 Associates Accounted for using the Equity Method

(i) Investment is initially recorded at cost, identifying any goodwill/capital reserve arising at the time of acquisition.

(ii) Carrying amount of investment is adjusted for the post acquisition change in the investor's share of net assets of the investee.

(iii) The consolidated statement of profit and loss reflects the investor's share of the results of the operations of the investee.

(iv) Goodwill/capital reserve arising on the acquisition should be included in the carrying amount of investment in the associate should be disclosed separately. A separate entry for goodwill is not made.

Investment in Associates (CFS)

To Bank (Initial Investment)	By Bank (dividends)
To Consolidated P&L (Share of Profit)	By Consolidated P&L (Share of Loss)
	By Bal c/d (closing balance)

The board conclusions that can be drawn:

a. In CFS, investment is to be recorded at cost.
b. Surplus or deficit in cost and net asset to be recorded as goodwill or capital reserve.
c. Distributions received from an investee reduce the carrying amount of the investment.
d. Any subsequent change in share in net asset is adjusted in cost of investment and goodwill/capital reserve.
e. Consolidated profit & loss shows the investor's share in the results of operations of the investee.

2.4 Circumstances under which Equity Method is followed

Equity method is followed by all the enterprise having significant influence on their associates except

a. Control is intended to be temporary

b. It operates under severe long term restrictions, which significantly impair its ability to transfer funds to the investor.

Investor can discontinue the use of equity method from the date:

(i) It ceases to have significant influence in an associate but retains, either in whole or in part, its investments.

(ii) Associate operates under the severe long-term restrictions that significantly impair its ability to transfer funds to the investor

From the date of discontinuing the use of equity method, investment should be accounted for in accordance with AS 13, Accounting for Investments. → **The carrying amount of the investment at that date should be regarded as cost.**

2.5 Application of the Equity Method

a. Many rules followed are like consolidated financial statement rules.

b. Investment in an associate should be recorded as per the equity method from the date when such relation comes in effect.

c. Investment is recorded at cost and any difference in the cost and investor's share in equity on the date of acquisition is shown as goodwill or capital reserve.

Step Acquisition in case of an associate

The stake of 20% in the associate can be acquired either in one go or in more than one transaction

↓

Adjustment should be made with each transaction

1. Under equity method, an investor's share of losses of an associate equals or exceeds the carrying amount of the investment, the investor ordinarily discontinues recognizing its share of further losses and the investment is reported at nil value.

2. As far as possible the reporting date of the financial statements should be same for consolidated financial statements.

3. If the reporting date is different for the financial statements and the investor then the adjustments should be made for the effects of significant transactions or other events that occur between those dates.

The difference b/w the reporting dates of the concern and the CFS should not exceed 6 months

4. Accounting policies followed should be uniform for like transactions and other events in similar circumstances.
5. If accounting policies are not uniform then adjustments are made in the individual financial statements to bring in line with the consolidated statement.
6. The carrying amount of investment should be reduced to recognize a decline, other than temporary, in the value of investment.

2.6 Contingencies

In accordance with AS 4, the investor discloses in the CFS

a. Its share of contingencies and capital commitments of an associate for which it is also contingent liability.

b. Contingencies that arise because the investor is severally liable for the liabilities of the associate.

2.7 Disclosure

1. An appropriate listing and description of associates including the proportion of ownership interest and of voting power held should be disclosed.
2. Investments in associates using the equity method should be classified as long term investments and disclosed separately in the consolidated balance sheet.
3. The investor's share of the profits or losses of such investments should be disclosed separately in the consolidated statement of profit and loss and any extraordinary or prior period items should also be disclosed separately.
4. The name of the associate of which reporting date is different from that of the financial statements of an investor and the differences in reporting dates should be disclosed in the consolidated financial statements.
5. In case an associate uses accounting policies other than those adopted for the consolidated financial statements and if it is not practicable to make appropriate adjustments to the associate's financial statements, then the fact should be disclosed along with brief description.
6. If an associate is not accounted for using the equity method the reasons for not doing the same.
7. Goodwill/capital reserve arising on the acquisition of an associate by an investor should be disclosed separately though it is included in the carrying amount of investment

Relevant Explanations to AS 23

Treatment of proposed dividend in associates in consolidated financial statements

In case an associate has made a provision for proposed dividend in its financial statements, the investor's share of the results of operations of the associate should be computed without taking into consideration the proposed dividend.

Consideration of potential equity shares for determining whether an investee is an associate

The potential equity shares of the investee held by the investor should not be taken into account for determining the voting power of the investor.

AS 27
FINANCIAL REPORTING OF INTERESTS IN JOINT VENTURES

1. Introduction

AS 27 set out principles and procedures for accounting of interests in joint venture and reporting of joint venture assets, liabilities, income and expenses in the financial statements of ventures and investors regardless of structures or forms under which the joint venture activities take place.

The standard deals with 3 types of joint ventures

2. Jointly controlled operations (JCO)
3. Jointly controlled assets (JCA)
4. Jointly controlled entities (JCE).

It is required to accounting for joint ventures in consolidated financial statements according to proportionate consolidation method, contained in AS 27, apply only when consolidated financial statements are prepared by venture.

2. Definitions

Joint venture: It is a contractual agreement whereby two or more parties undertake an economic activity, which is subject to joint control.

Essential conditions for any business relation to qualify as joint venture

1. Two or more parties coming together: Parties can be an individual or any form of business organisation

2. Venturers undertake some economic activity:

Economic activity means activities with the profit making motive. Joint venture is separate from the regular identity of the venturers, it may be in the form of independent and separate legal organization other than regular concern of the venture engaged in the economic activity.

3. Venturers have joint control on the economic activity:

Operating and financial decisions are influenced by the venturers and they also share the results of the economic activity.

4. There exists a contractual agreement:

The relationship between venturers is governed by the contractual agreement. This agreement can be in the form of written and signed agreement or as minutes of venture meeting or in any other written form.

Joint control: Contractually agreed sharing of control over an economic activity

Control: Power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.

Venturer: Party to a joint venture and has a joint control over that joint venture.

Investor: A party to a joint venture and does not have joint control over that joint venture.

Proportionate consolidation: It is a method of accounting and reporting whereby a venturer's share of each of the assets, liabilities, income and expenses of a jointly controlled entity is reported as separate line items in the venturer's financial statements.

a. Contractual Arrangement

Joint venture governed on the basis of contractual agreement

Non-existence of contractual agreement will be excluded from the scope of AS 27

Joint venture with contractual agreement will be excluded from the scope of AS 27 only if the investment qualifies as subsidiary under AS 21

Contractual agreement can be in the form of written contract, minutes of discussion between parties, articles of the concern or by-laws of the relevant joint venture.

The content of the contract should include the following:

a. The activity, duration and reporting obligations of the joint venture.

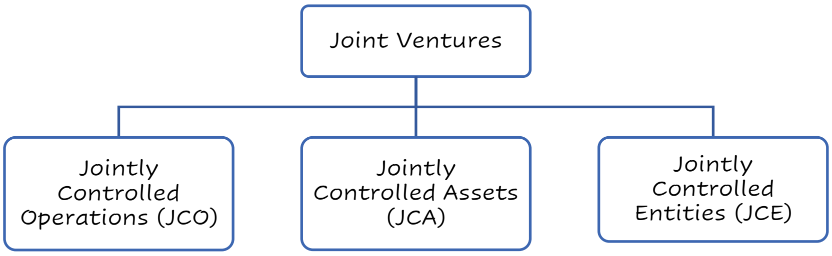
b. The appointment of board of directors or equivalent governing body of the joint venture and the voting rights of the venturers.

c. Capital contributions by the venturers.

d. The sharing by the venturers of the output, income, expenses or results of the joint venture.

The main object of contractual agreement is to distribute the economic control among the venturers, it ensures that no venture should have unilateral control.
If contractual agreement is signed by a party to safeguard its rights, such agreement will not make the party a venture.

3. Forms of Joint Ventures



Any structure which satisfies the following characteristics can be classified as joint ventures:
a. Two are more venturers are bound by a contractual arrangement and
b. The contractual agreement establishes joint control.

a. Jointly Controlled Operations

1. Ventures do not create a separate entity for their joint venture business but they use their own resources.

2. The joint venture agreement usually provides means by which the revenue from the jointly controlled operations and any expenses incurred in common are shared among the venturers.

3. All the transactions of joint venture are recorded in their books only and do not maintain separate set of books as there is no separate legal entity.

Key features of JCO

a. Each venturer has his own separate business.

b. There is no separate entity for joint venture business.

c. All venturers are creating their own assets and maintain them.

d. Each venture record only his own transactions without any separate set of books maintained for the joint venture business.

e. There is a common agreement between all of them.

f. Venturers use their assets for the joint venture business.

g. Venturers met the liabilities created by them for the joint venture business.

h. Venturers met the expenses of the joint venture business from their funds.

i. Any revenue generated or income earned from the joint venture is shared by the venturers as per the contract.

The assets and liabilities used in the joint venture are those of the venturers.

Accounting in case of JCO

In respect of its interests in jointly controlled operations, a venture should recognise in its separate financial statements and consequently in its consolidated financial statements:

a. The assets that it controls and the liabilities that it incurs and

b. The expenses that it incurs and its share of the income that it earns from the joint venture.

The venturers may prepare accounts for internal management reporting purposes for assessing the performance of the joint venture.

b. Jointly Controlled Assets (JCA)

Separate legal entity is not created.

Venturer owns the assets jointly, which are used by them for generating economic benefit to each of them.

They take up any expenses and liabilities related to the joint assets as per the contract

a. There is no separate legal identity.
b. There is a common control over the joint assets.
c. Venturers use this asset to derive some economic benefit to themselves.
d. Each venture incurs separate expenses for their transactions.
e. Expenses are jointly held assets are shared by the venturers as per the contract.
f. In their financial statements, venturer shows only their share of the assets and total income earned by them along with total expenses incurred by them.
g. No adjustments or other consolidation procedures are required in respect of assets, liabilities, income and expenses when the venture presents consolidated financial statements as they are already recognised in the separate financial statements.
h. Financial statements may not be prepared for the joint venture, although the venturers may prepare accounts for internal management reporting purposes so that they may assess the performance of the joint venture.

Differences b/w JCO and JCA

JCO	JCA
1.Venturers use their own assets	1.Venturers jointly own the assets to be used
2.It is an agreement to jointly carry on the operations to earn income	2.It is an agreement to jointly construct and maintain an asset to generate revenue to each venture
3.All expenses and revenues are shared at an agreed ratio	3. Only expenses on joint assets are shared at the agreed ratio.

c. Jointly Controlled Entities

This is where venture creates a new entity for their joint venture business.

The entity operates in the same way as other enterprises, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.

All venturers pool their resources under new banner and this entity purchases its own assets, create its own liabilities, expenses are incurred by the entity itself and sales are also made by this entity.

The net results is shared in the ratio agreed upon in the contractual agreement.

A jointly controlled entity maintain its own accounting records and prepares and presents financial statements.

Venturers usually contributes cash or other resources to the entity and these are included in the accounting records of the venture and are recognised in its separate financial statements as an investment in the joint controlled entity.

d. Consolidated Financial Statements of a Venturer

Proportionate Consolidation

It is a method of accounting and reporting whereby a venturer's share of each of the assets, liabilities, income and expenses of a jointly controlled entity is reported as separate line items in the venturer's financial statements.

This method can be followed except:

a. Investment is intended to be temporary

b. Joint venture operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the venturers.

Venturer can discontinue the use of proportionate consolidation method from the date that:

1. It ceases to have joint control in the joint venture but retains, either in whole or in part, its investments.

2. The use of this method is no longer appropriate.

After discontinuing the use of proportionate method

a. If interest in entity is more than 50%, investments in such joint ventures should be accounted for in accordance with AS 21.

b. If interest is 20% or more but up to 50%, investments are to be accounted for in accordance with AS 23.

c. In all other cases investment in joint venture is treated as per AS 13, Accounting for Investments.

d. The carrying amount of the investment at the date on which joint venture relationship ceases to exist should be regarded as cost.

Features of Proportionate Consolidation Method

a. Stress is given on substance over form.

b. Venturer's share of joint assets, liabilities, expenses and income are shown on the separate lines in the consolidated financial statements.

c. Most of the provisions are similar to the provisions of AS 21.

d. As far as possible the reporting date of the financial statements of jointly controlled entity and venturers should be same.

e. Practically it is not possible to draw up the financial statements to such date and those financial statements are drawn up to different reporting dates and adjustments should be made in the books of joint venture.

f. Any asset or liability and income and expense cannot be adjusted by another liability or asset and expense or income.

g. On the date of interest in joint entity is acquired, if the interest of venture in net assets of the entity is less than the cost of investment then the difference will be recognized as goodwill and if net asset is more than cost of investment, then the difference is recognized as capital reserve in consolidated financial statement.

h. An investor who don't have joint control in the entity is like associate as in AS 23. The treatment of losses is similar to AS 23.

i. If investor's share in loss of the joint entity is in excess of his interest in net asset, this excess loss will be recognized by the venturers, In future when the entity starts reporting profits, investor's share of profits will be provided to venture till total amount is equivalent to absorbed losses.

e. Transactions between a venturer and joint venture

1. Sells asset to joint venture: Recognise only that proportion of gain or loss which is attributable to the interests of the other venturers.

Venturer recognise the full amount of loss only when the contribution or sale provides evidence of a reduction in the net realisable value of current assets or an impairment loss.

2. Purchases the assets from joint venture: Venturer will not recognized his share of profits in the joint venture of such transaction unless he disposes off the assets.

Venturer should recognise his share of the losses resulting from these transactions in the same way as profits

3. Joint venture is in the form of separate entity: The above provisions (1&2) will be followed only for consolidated financial statement. In the books of venture, profit or loss from such transactions are recognised in full.

f. Operators of Joint Ventures

Payment to operators is recognized as expense in CFS and in books of the operator as per AS 9, Revenue Recognition.

The operator may be any of the venturers, in this case any amount received by him, as management fees for the service will be recognized.

g. Disclosure

Venturer should disclose the aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities:

a. Any contingent liabilities that the venture has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities which have been incurred jointly with other venturers.

b. Its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable.

c. Those contingent liabilities that arise because the venture is contingently liable for the liabilities of the other venturers of a joint venture.

Venturer should disclose the aggregate amount of the following commitments:

1. A list of all joint ventures and description of interests in significant joint ventures.

2. In respect of jointly controlled entities, the proportion of ownership interest, name and country of incorporation or residence should also disclose.

3. A venture should disclose, in its separate financial statements, the aggregate amounts of each of the assets, liabilities, income and expenses related to its interests in the jointly controlled entities.