TRAINING MATERIAL

Implementation of Accounting Standards

- With Specific Reference to Educational Institutions

A JOINT INITIATIVE OF

Ministry of Human Resource Development, Govt of India

& The Institute of Chartered Accountants of India

The Institute of
Chartered Accountants of India
A Statutory Body set up by an Act of Parliament

ICAI VISION 2030

To be World's leading accounting body: ICAI envisions becoming the world's leading accounting body by playing a predominant role in setting world class standards in identified service areas developing thought leadership and research that addresses concerns of countries, developed, developing and under-developed.

A regulator and developer of Trusted and Independent Professionals: ICAI will lay further thrust on its regulatory and developmental role that sets the highest standards of professional and ethical conduct of its members as a core value. Each and every member of ICAI will not only have the obligation to maintain exacting standards of clarity, transparency and disclosure and present an independent, informed and balanced opinion but ICAI will make examples of delinquent members to ensure this core value is embedded in the DNA of its members.

With World Class Competencies: ICAI will ensure that members have the right skills to serve global markets which are regularly updated and are relevant in the changing economic order. ICAI will provide holistic education, effective practical training and continuous professional development to ensure that the knowledge base of the profession keeps pace with emerging global practices and innovations.

In accounting, assurance, taxation, finance and business advisory services: ICAI will strengthen facilities available for providing education, training and continuous updation of knowledge as also research and development relevant in current times to establish thought leadership in these areas where members of ICAI have been providing services.

TRAINING MATERIAL

Implementation of Accounting Standards

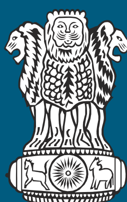
- With Specific Reference to Educational Institutions

A JOINT INITIATIVE OF
Ministry of Human Resource Development, Govt of India
& The Institute of Chartered Accountants of India

TRAINING MATERIAL

Implementation of Accounting Standards

- With Specific Reference to Educational Institutions



Ministry of Human Resource Development
Government of India

The Institute of
Chartered Accountants of India

A Statutory Body set up by an Act of Parliament

The views expressed in this publication are those of the authors and do not necessarily represent the views of either the organisation to which they belong or the Institute of Chartered Accountants of India.

The Institute of Chartered Accountants of India, as a matter of policy, disclaims its responsibility for any views expressed by its employees.

This publication is strictly for private circulation only.

2012. The Institute of Chartered Accountants of India
E-mail: icaiho@icai.org
Website: www.icai.org

Published By
The Institute of Chartered Accountants of India
'ICAI Bhawan', Indraprastha Marg
New Delhi - 110 002
INDIA

Contents

Contents
Contents

CHAPTER		PAGE
1.	**Accrual Accounting**	02
2.	**Financial Statements - Classification & Terminology**	05
3.	**Double Entry Accounting System**	17
4.	**Generation of Trial Balance and Preparation of Financial Statements**	41
5.	**New Chart of Accounts**	56
6.	**How to prepare opening Balance Sheet**	57
7.	**Accounting Standards**	64
	AS 1 - Disclosure of Accounting Policies	68
	AS 2 - Valuation of Inventories (Revised)	73

Contents

Contents
Contents

AS 3 - Cash Flow Statement (Revised) **81**

AS 4 - Contingencies and Events Occurring after the Balance Sheet Date **90**

AS 5 - Net Profit or Loss for the Period, Prior PeriodItems and Changes in Accounting Policies (Revised) **93**

AS 6 - Depreciation Accounting (Revised) **96**

AS 9 - Revenue Recognition **103**

AS 10 - Accounting for Fixed Assets **108**

AS 11 - The Effects of Changes in Foreign Exchange Rates (Revised) **114**

AS 12 - Accounting for Government Grants **121**

AS 13 - Accounting for Investments **126**

AS 15 - Employee Benefits **129**

AS 16 - Borrowing Costs **136**

AS 17 - Segment Reporting **142**

AS 18 - Related Party Disclosures **152**

AS 19 - Leases **157**

Contents

Contents

Contents

AS 24 - Discontinuing Operations 172

AS 25 - Interim Financial Statement 176

AS 26 - Intangible Assets 183

AS 28 - Impairment of Assets 195

AS 29 - Provisions, Contingent Liabilities and Contingent Assets 207

8. Illustrations on Accounting Standards 215

9. Examples on Accounting Standards 288

10. MCQs on Accounting Standards 292

Reading Material has been contributed by...

1. CA. O. P. Saluja
2. CA. (Dr.) Gurmeet Grewal
3. CA. Sanjeev Singhal
4. CA. Pankaj Goel
5. Shri Vijay Kapur, Director, Board of Studies, ICAI
6. CA. Namrata Khandelwal, Assistant Secretary, ICAI

Message

Message
Message

CA. Jaydeep N Shah
President, ICAI

As a part of its endeavour to be a Partner in Nation Building, The Institute of Chartered Accountants of India (ICAI) has been proactively reaching out to the institutions and offering its services in areas such as reforms in accounting system(s), capacity building including training of accounting and other personnel, identification of new areas of revenue generation, development of accounting manual, thereby ensuring proper and better utilization of scarce resources available with the institutions.

Perusing the same, ICAI had approached Ministry of Human Resource Development (MHRD) with its suggestions to maintain uniformity in presentation of financial statements, promoting disclosure and transparency in financial information of various educational institutions.

Considering the merit made out in the case, a Working Group was constituted consisting of nominees from ICAI and MHRD. Accepting the recommendations made by the said working group, the MHRD is now organizing a series of capacity building programmes across the country to train the staff of educational institutions in coordination with ICAI. This comprehensive reading material being brought out by the Institute is a landmark in this direction.

I would place on record my deep sense of appreciation for the dedicated and untiring efforts put in by the officials of Ministry of HRD and ICAI for executing this event. I also thank the faculty who would spare their valuable time to address the gathering in this programme.

I am sure the participants would be greatly enriched with the deliberations and wisdom shared by eminent faculty at the programme.

I wish the programmes huge success.

CA. Jaydeep N Shah
President, ICAI

Programme Structure

DAY ONE	
	INAUGURATION
Technical Session I	**Implementation of Accounting Standards in Educational Institutions of Department of Higher Education: The Way Forward** ■ standard basis of accounting ■ uniformity in presentation of financial statements ■ uniformity in disclosure practices ■ application of accounting standards for preparation and presentation of financial statements
Technical Session II	**Accounting of Fixed Assets** ■ **Accounting standard 6 -** Depreciation Accounting ■ **Accounting standard 10 -** Accounting for Fixed Assets ■ Open session
Technical Session III	**Accounting Cycle : Practical Concepts** ■ **Accounting standard 1 -** Disclosure of Accounting Policies ■ **Accounting standard 3 -** Cash Flow Statements ■ **Accounting standard 9 -** Revenue Recognition ■ Open session

DAY TWO	
Technical Session IV	**Fund based Accounting** ■ **Accounting Standard 12-** Accounting for Government Grants ▫ Classification of funds received by educational institutions ▫ Fund Based disclosures ■ Open session
Technical Session V	■ **Transitional issues** in conversion from Cash to Accrual Basis of Accounting ■ Open session
	Valedictory & Wrap up Session

Accrual Accounting

Basis of Accounting

The term basis of accounting refers to the timing of recognition of revenues, expenses, assets & liabilities in accounts.

Cash Basis of Accounting

Under cash basis of accounting, transactions are recorded when the related cash receipts or cash payments take place. Revenues and transfers-in are not recorded in the accounts until cash is received, and expenditures/expenses and transfers-out are not recorded, until cash is disbursed. The output of cash basis of accounting is a Statement of Receipts and Payments that classifies cash receipts and cash payments under different heads. A statement of assets and liabilities is not prepared.

The adoption of cash basis of accounting owes its origin to the pre-eminence of the budget as the principal means of financial control. The cash basis of accounting fails to meet most of financial reporting objectives. The measurement of performance and financial position under the cash basis of accounting is unlikely to yield correct results, because the evaluation of performance requires the measurement of accomplishment (the revenues) during a period and the efforts expended for those accomplishments (the expenses). In current scenario, the timings of cash receipts and cash payments may not coincide with earning of revenues or incurrence of expenses. Also, the measures of performance based on cash basis of accounting are to be modified even if there is even a slight variation in the timings of cash receipts or payments. e.g. a budgetary deficit can be cancelled merely by postponing the payment of certain bills by a few days. No distinction is made between expenditure on construction of infrastructural facilities such as buildings, vehicles etc. and expenditures on routine items such as salaries, rents etc. Similarly, a substantial expenditure on major changes to an asset that results in an increase in its life is treated under the cash basis of accounting as no different from the revenue expenditure on normal repairs and maintenance.

Accrual Basis of Accounting

Under the accrual basis of accounting, most transactions are recorded when they occur, regardless of when cash is received or disbursed. The accrual basis of accounting includes considerations relating to deferral, allocation, depreciation and amortisation. The major difference between accrual accounting and cash accounting is in timing of recognition of revenues, expenses, gains and losses.

The accrual basis is the superior method of accounting for the economic resources of any organisation. It results in

accounting measurement based on the substance of transactions and events, and thus enhances their relevance, neutrality, timelines, completeness and comparability.

Under accrual accounting, entries are made on the dates when revenue or expenses fall due and not on the date when they are paid or received. Accrual basis of accounting is a scientific system for reporting income and also for preparation of financial statements. It is based on two basic accounting principles.

1. Revenue Recognition Principle
2. Matching Principle

According to the Revenue Recognition Principle, revenue is reported in the financial statements in the accounting period in which cash representing that revenue is actually received. According to Matching Principle, all expenses associated with the generation of revenue must be matched against that revenue in the same period in which revenue was actually earned.

Consequently under accrual basis of accounting, cash received in advance for services to be rendered in future are not recognized as revenues at all and are treated as deferred revenue and shown as liability in Balance Sheet. Similarly expenses paid in advance are not matched against the revenue of current year and treated as prepaid expenses and shown as asset in Balance Sheet. Likewise, income earned, but not received in cash is taken as accrued income, and is treated as income of current year and shown as asset in Balance Sheet. Expenses incurred but not paid for is provided for and charged against revenue of current year and shown as liability in the Balance Sheet.

The adjustments made on accrual basis ensure better financial statements. Accrual basis is the most widely accepted basis of accounting. Accrual basis of accounting is a scientific method. It emphasizes on proper recognition of income & expenses to have a clear picture of receivables and payable without inflating/deflating income or expenses.

Benefits of Accrual Accounting

1. Accrual basis of accounting allows users to
   i. Assess the accountability for all resources the entity controls and the deployment of those resources.
   ii. Assess the performance, financial position and cash flows of the entity.
   iii. Make decisions about providing resources to, or doing business with, the entity.
   iv. Evaluate an institution's ongoing ability to finance its activities and to meet its liabilities and commitment.

2. Accrual basis of accounting provides information on an entity's overall financial position and current stocks of assets & liabilities and changes in financial position. Educational Institutions need this information to
   i. Make decisions about the feasibility of financing the services it wishes to provide.
   ii. Demonstrate accountability to the public for the management of its assets and liabilities
   iii. Plan for future funding requirements of assets maintenance and replacement.
   iv. Plan for the repayment of, or repayment of existing liabilities.
   v. Manage its cash position and funding requirement.
   vi. Demonstrate its performance in terms of service costs, efficiency and accomplishments.

vii. Assess whether current revenues are sufficient to cover the costs of current programs and services.

viii. Record the total costs, including depreciation of physical assets and amortisation of intangible assets, of carrying out specific activities.

ix. Assess whether it can provide and the extent to which it can afford new programs and services.

3. Accrual accounting requires maintenance of complete records of assets and liabilities. It facilitates better management of assets, including better maintenance, more appropriate replacement policies, identification & disposal of surplus assets, and better management of risks such as loss due to theft or damage.

4. Accrual accounting provides a consistent framework for the identification of existing liabilities, and contingent liabilities. It provides information on the impact of existing liabilities on future resources.

5. Accrual basis of accounting shows how the activities are being financed and met its cash requirements

6. Accrual basis of accounting highlights the impact of financing decision on net assets/ equity and may lead the institution to take longer-term view when making financing decisions than is generally possible, when relying on cash reports. Under the accrual basis of accounting, the financial statement will include a Statement of Financial Position, which discloses information about assets and liabilities. Where assets and liabilities are not equal, a residual figure for net assets/ equity will be reported. Changes in an entity's net assets/equity between two reporting dates reflect the increase or decrease in its wealth during the accounting period. Information or changes in financial position means that institution may be held accountable for the financial impact of its decisions on both current and future net assets/ equity.

Modern Accounting Systems are a necessary pre-requisite to raise finances from the capital markets and financial institutions. Quite apart from a financial perceptive, a transparent accounting system contributes to good governance enabling users to understand the financial transactions and the extent of sub-cities for services, which they pay for through taxes. From the twin perspectives of improved governance and better financial management, it is essential that an accrual basis of accounting should be introduced.

Financial Statements
- Classification & Terminology

Terminology Used in Double Entry Accounting System on accrual basis

- **Account -** A formal record of a particular type of transaction expressed in money or other unit of measurement and kept in a recorded form. In accounting separate record of each individual, asset, liability, expenses or income is kept. The place where such a record is maintained is termed as 'Account'. Such as the Account of Ranbir, the Account of Ram, the Account of Machinery, the Account of Salary, the Account of Rent and likewise. All transactions entered into with Ranbir will be recorded in the Account of Ranbir.

  All accounts are divided into two sides.

  The left side of an account is arbitrarily or traditionally called Debit side and the right side of an account is called Credit side.

  In the abbreviated form, Debit is written as Dr. and Credit is written as Cr.

- **Accounting Entry -** A record of financial transaction in the books of account like journal, ledger, cash book, etc.

- **Account Payable -** Amount owed by an enterprise on account of goods purchased or services received or in respect of contractual obligations. Also termed as Creditor.

- **Accounting Period -** The period of time for which financial statements are customarily prepared.

- **Accounting Principle -** The principles and procedures under which the accounts of an organization are maintained/ to be maintained are called accounting principles. An accounting principle is an adaptation or special application of a principle necessary to meet the peculiarities of an organization or the needs of its management. Thus, principles are required for the computation of depreciation, the recognition of capital expenditures etc.

- **Account Receivable -** Persons from whom amounts are due for goods sold or services rendered or in respect of contractual obligations. Also termed as debtor. The words 'Receivables' and 'Debtors' are used interchangeably.

- **Accounting Standards -** The Accounting Standards as laid down by the Institute of Chartered Accountants of India are set of neutral principles for drawing up the financial statements so that there is the minimum possible

ambiguity and uncertainty about the figures contained in those statements. The objective of Accounting Standards is, therefore, to reduce the accounting alternatives in the preparation of financial statements within the bounds of rationality, thereby ensuring comparability of financial statements of different enterprises with a view to provide meaningful information to various users of financial statements to enable them to make informed economic decisions.

- **Accounting Unit -** An accounting unit shall be defined as a department, college identified by the educational institution as a unit for maintenance of accounting records.

- **Accounting Year -** Accounting year means a year commencing on the first day of the accounting period. In case of Educational Bodies, it would refer to the period from 1st April of a year to 31st March next year.

- **Accrual -** Recognition of revenues and costs as they are earned or incurred (and not as money is received or paid). It includes recognition of transactions relating to assets and liabilities as they occur irrespective of the actual receipts or payments.

- **Accrual Basis of Accounting -** The basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate. The elements recognized under accrual accounting are assets, liabilities, revenue and expenses.

- **Accrued & Due -** In respect to an asset (or a liability) it means a claim which has become enforceable, which arises from the sale/ rendering (purchase) of goods/ services or otherwise and has become receivable (payable). In respect to an income (or an expense) it means the amount earned (incurred) in an accounting period, for which a claim has become enforceable, and it arises from the sale/rendering (purchase) of goods/services or otherwise and has become receivable (payable).

- **Accrued But Not Due -** In respect to an asset (or a liability) it means a claim which has not yet become enforceable, which accumulates with the passage of time or arises from the sale/ rendering (purchase) of goods/ services which, on the date of period-end, have been partly performed and are not yet receivable (payable). In respect to an income (or an expense) it means the amount earned (incurred) in an accounting period, but for which no enforceable claim has become due in that period. It accumulates with the passage of time or arises from the sale/ rendering (purchase) of goods/services goods which, at the date of accounting, have been partly performed and are not yet receivable (payable).

- **Accumulated Depreciation -** The total to date of the periodic depreciation charges on depreciable assets.

- **Advance -** Payment made on account of, but before completion of, a contract, or before acquisition of goods or receipt of services.

- Amortisation - The gradual and systematic writing off of an asset or an account over an appropriate period. The amount on which amortisation is provided is referred to as amortisable amount. Depreciation accounting is a form of amortisation applied to depreciable assets. Depletion accounting is another form of amortisation applied

to wasting assets. Amortisation also refers to gradual extinction or provision for extinction of a debt by gradual redemption or sinking fund payments or the gradual writing off to revenue of miscellaneous expenditure carried forward.

- **Annual Report -** Any report prepared at yearly intervals. A statement of the financial condition and operating results of an educational institutions, prepared yearly for submission to interested parties; summarising its operations for the preceding year and including a balance sheet, income & expenditure statement, often a receipts & payment statement, and the auditor's report, together with comments by the Officer of the educational institutions on the year's operations.

- **Assets -** Assets are tangible objects or intangible rights owned by an Institution and carrying probable future benefits. Assets are resources controlled by an Institution as a result of past events and from which future economic benefits or service potential expected to flow to the Institution. Assets provide the means to achieve their objectives. Assets that are used to deliver goods and services in accordance with an institution's objectives but which do not directly generate net cash inflows are often described as embodying "service potential". Assets that are used to generate net cash inflows are often described as embodying "future economic benefits".

- **Bad Debts -** Debts owed to the educational institutions, which are considered to be irrecoverable, e.g., arrears of taxes, fees and other revenue left uncollected and considered to be irrecoverable.

- **Balancing-** It means writing of the difference that exists between the amount columns of the two sides, namely debit and credit in the smaller side so that the totals of the two sides are equalized.

- **Balance Sheet -** A statement of the financial position of an educational institutions as at a given date, which exhibits its assets, liabilities, capital, reserve and other account balances at their respective book values.

- **Bank Reconciliation Statement -** A statement, which reflects the nature and amount of transaction (s) not responded either by the educational institutions or the bank as on a particular date. Such statement may also reflect errors/ omission in the recording of transaction inter-se between the educational institutions and the Bank.

- **Books of Original Entry -** A record book, recognised by law in which transactions are successively recorded, and which is the source of postings to ledgers; a journal. Books of original entry include general and special journals, such as cash books.

- **Budget -** Budget is a financial plan, an expression of financial intent. It sets forth the expenditures that bodies are expected to incur during the year on various programmes and the means of financing them. A budget thus provide both, the authorization of, and limitations on, the amounts that may be spent for particular purposes.

- **Capitalisation -** An expenditure for a fixed asset or addition thereto that has the effect of enlarging physical dimensions, increasing productivity, lengthening future life, or lowering future costs.

- **Capital Expenditure -** An expenditure intended to benefit future period in contrast to a revenue expenditure, which benefits a current period. The term is generally restricted to expenditure that adds fixed asset units or that has the effect of improving the capacity, efficiency, life span or economy of operations of an existing asset.

- **Capital Work in Progress -** Expenditure on capital assets which are in the process of construction or completion.

- **Cash Book -** A book of original entry maintained on daily basis for cash receipts and disbursement in its chronological order.

- **Cash flow Statement -** A financial statement prepared for an accounting period to depict the inflows and outflows of cash and cash equivalents of an enterprise. The cash flow statement reports cash flows classified by operating, investing and financing activities.

- **Chart of Accounts -** A systematically arranged list of accounts applicable to a specific concern, giving account names and numbers, if any.

- **Contingent Liability -** An obligation relating to an existing condition or situation which may arise in future depending on the occurrence or non-occurrence of one or more uncertain future events. No accounting entry needs to be passed for a contingent liability. However, disclosure is required in the Balance Sheet.

- **Contra Entry -** An item on one side of an account which offsets fully or in part one or more items on the opposite side of the same account.

- **Cost -** The amount of expenditure incurred on or attributable to a specified article, product or activity.

- **Cost of Acquisition -** The cost of acquisition of a Fixed Asset comprises its purchase price and includes import duties and other non-refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price.

- **Credit -** A book-keeping entry recording the reduction or elimination of an asset or an expense, or the creation of or addition to a liability or item of net worth or revenue; the amount so recorded.

- **Current Assets -** Cash and other assets that are expected to be converted into cash or consumed in rendering of services in the normal course of operations of the educational institutions.

- **Current Liability -** Liability including loans, deposits, expenses and bank overdrafts which fall due for payment in a relatively short period, normally not more than twelve months.

- **Debit -** The goods or benefit received from a transaction; a book-keeping entry recording the creation of or addition to an asset or an expense, or the reduction or elimination of a liability, or item of net worth or revenue; the amount so recorded.

- **Deferred Revenue Expenditure -** Expenditure for which payment has been made or a liability incurred but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods. This is also referred to as Deferred Expenditure.

- **Deficit -** The excess of expenditure over income of the Educational Institutions for an Accounting Period under consideration.

- **Depreciable Amount -** The historical cost or other amount substituted for historical cost of a depreciable asset in the financial statements, less the estimated residual value.

- **Depreciation -** A measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. It is allocated so as to charge a fair proportion in each accounting period during the useful life of the asset. It includes amortisation of assets whose useful life is predetermined and depletion of wasting assets.

- **Depreciation Method -** The arithmetic procedure followed in determining a provision for depreciation (an expense) and maintaining the accumulated balance.

- **Depreciation Rate -** A percentage which when applied to the depreciable amount will yield depreciation expense for a year.

- **Disclosure -** Process of divulging accounting information so that the content of Financial Statements is understood.

- **Dividend Income -** An income received from investments by an educational institution in shares/ units.

- **Double-Entry Bookkeeping -** It is a system of accounting in which both debit and credit aspects of each transaction is recorded. It affects at least two accounts.

  You've probably heard the saying, **"Money doesn't grow on trees."** It means that money must come from somewhere-it doesn't just "appear." Double-entry accounting is a method of record-keeping that lets you track just where your money comes from and where it goes. Using double-entry means that money is neither gained nor lost-**it is always transferred from somewhere (a source account) to somewhere else (a destination account).** This transfer is known as a transaction, and each transaction requires at least two accounts.

- **Earmarked Funds -** Funds representing Special Funds to be utilised for specific purposes.

- **Expenses -** A cost relating to the operations of an accounting period or to the revenue earned during the period or the benefits of which do not extend beyond that period.

- **Fair Market Value -** Price at which property would change hands between a buyer and a seller without any compulsion to buy or sell, and both having reasonable knowledge of the relevant facts.

- **Financial Statement -** A balance sheet, income statement (income and expenditure), receipts & payment statement or any other supporting statement or other presentation of financial data derived from accounting records.

- **Fixed Asset -** Asset held for the purpose of providing services and that is not held for resale in the normal course

of operations of the educational institutions.

- **Fixed Deposit -** Deposit for a specified period and at specified rate of interest.

- **Fund -** The term fund refers to the amount set aside for a general or specific purpose, whether represented by specifically earmarked assets or not.

- **Generally Accepted Accounting Principles (GAAP) -** Conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. In India, these principles are set by the Accounting Standards Board (ASB) established by the Council of the Institute of Chartered Accountants of India.

- **Grants -** Grants are assistance by State Government and/ or State Government in cash or kind to an Institution for past or future compliance with certain conditions.

- **Gross Block -** The total cost of acquisition/ purchase of all the Fixed Assets of the educational institutions.

- **Income -** Money or money equivalent earned or accrued during an accounting period, increasing the total of previously existing net assets, and arising from provision of any type of services and rentals.

- **Income and Expenditure Statement -** A financial statement, prepared by educational institutions in double entry accounting system on accrual basis to present their revenues and expenses for an accounting period and to show the excess of revenues over expenses (or vice-versa) for that period. It is similar to Profit and Loss Statement and is also called revenue and expense statement.

- **Interest -** The service charge for the use of money or capital, paid at agreed intervals by the user, and commonly expressed as an annual percentage of outstanding principal.

- **Internal Control -** The plan of organization and all the methods and procedures adopted by the management of an Body to assist in achieving management's objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

- **Investments -** Assets held not for operational purposes or for rendering services, i.e., assets other than fixed assets or current assets (e.g. securities, shares, debentures, immovable properties).

- **Inter unit transactions -** Transactions between one and more accounting units of the Bodies.

- **Infrastructure Assets -** Those assets with the characteristics of being, a part of a system or network, specialised in nature and do not have alternative uses, immovable, and subject to constraints on disposal.

- **Journal Book -** The book of original entry in which the 'dual aspect' of transactions other than those involving cash and/ or bank, along with explanations, is recorded in their chronological order , from which a posting is done in the relevant ledger.

- **Journal Entry -** Recording of transaction other than those involving cash and/ or bank by dividing into its debit and credit aspects.

- **Lapsed Deposits -** Deposits unclaimed for more than such period or periods as defined in the Act or provisions governing the educational institutions.

- **Ledger -** A compilation of all accounts used for accounting purposes.

Performa of Ledger

LEDGER

Group - Head **Ledger Account**

Date	Particulars	C.B. Folio	Debit		Credit		Dr. or Cr.	Balance	
			Rs.	P.	Rs.	P.		Rs.	P.

- **Lease -** A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period. A lease agreement also includes a Hire Purchase agreement. A lease is classified as a finance lease if it transfers substantially the entire risks and rewards incident to ownership. All other leases are classified as operating leases.

- **Liability -** An amount owing by one person to another, payable in money, or in goods or services: the consequence of an asset or service received or a loss incurred or accrued; particularly, any debt (a) due or past due (current liability), (b) due at a specified time in the future (e.g. funded debt, accrued liability), or (c) due only on failure to perform a future act (contingent liability).

- **Long Term Investments -** Any investment falling outside the ambit of current investments are treated as long-term investments.

- **Mortgage -** A lien on land, buildings, machinery, equipment, and other property, fixed or movable, given by a borrower to the lender as security for his loan; sometimes called a deed of trust.

- **Educational Fund -** The fund is the general operating fund of the educational institutions. It is used to account for all financial resources except those related to any special or trust funds.

- **Narration -** A brief description written below an Accounting Entry. It explains as to why the entry has been recorded and other related aspects of the entry.

- **Net Assets -** The excess of the book value of the assets of a Body over its external liabilities.

- **Net Block -** Gross Block less Accumulated Depreciation of all the Fixed Assets of the educational institutions.

- **Period End -** The last day of any Accounting Period, e.g., quarter, half-year or year-end.

- **Prepaid Expense -** Payment for expense in an accounting period, the benefit for which will accrue in the subsequent accounting period(s).

- **Ratio Analysis -** Analysis of relationship worked out among various accounting data which are mutually interdependent and which influence each other in a significant manner, arises from the fact that often absolute figures standing alone convey no meaning. They become significant only when considered with other figures. It also helps in comparing the actual or projected data for a particular educational institution to the data of that educational institution or any other educational institutions in order to analyse trends or relationship.

- **Receipt -** A written acknowledgement of something acquired; hence, an accounting document recording the physical receipt of cash / cheques.

- **Receipts & Payments Statement -** A financial statement prepared for an accounting period to depict the changes in the financial position and to present the cash received in and paid out in whatever form (cash, cheques, etc.) under certain headings. All non-cash related transactions are ignored while preparing this Statement.

- **Reconciliation -** It means identifying the difference between two items (i.e. amounts, balances, accounts or statements) so that the figures agree.
- **Revenue Expenditure -** It means outlay benefiting only the current year. It is treated as an expense to be matched against revenue.
- **Special Fund -** An amount set aside for a specific purpose represented by specifically earmarked assets.
- **Straight Line Method (SLM) -** The method under which the periodic charge for depreciation is computed by dividing the depreciable amount of a depreciable asset by the estimated number of years of its useful life.
- **Surplus -** The excess of income over expenditure of the educational institutions for an Accounting Period under consideration.
- **Trial Balance -** A list or abstract of the balances or of total debits and total credits of the accounts in a ledger, the purpose being to determine the equality of posted debits and credits and to establish a basic summary for financial statements.
- **Useful Life -** The period over which a depreciable asset is expected to be used by the enterprise; or (ii) the number of production or similar units expected to be obtained from the use of the asset by the enterprise.
- **Voucher -** A document which serves as an authorisation for any financial transaction and forms the basis for recording the accounting entry for the transaction in the books of original entry, e.g., Cash Receipt Voucher, Bank Receipt Voucher, Journal Voucher, Payment Voucher, etc.
- **Written Down Value (WDV) -** Written Down Value in respect of an asset, means its cost of acquisition or substituted value less accumulated depreciation.
- **Written Down Value (WDV) Method -** A method under which the periodic charge for depreciation of an asset is computed by applying a fixed percentage to its historical cost or substituted amount less accumulated depreciation (net book value). This is also referred to as "Diminishing Balance Method".

Accounting Concepts used in Double Entry Accounting System on accrual basis

Accounting Concepts are the necessary assumptions, conditions or postulates upon which the accounting is based. They are developed to facilitate communication of the accounting and financial information to all the readers of the Financial Statements, so that all readers interpret the statements in the same meaning and context.

The Accounting Concepts are as follows:

a. Entity Concept;
b. Dual Aspect or Accounting Equivalence Concept;
c. Going Concern Concept;
d. Money Measurement Concept;

e. Cost Concept;
f. Accounting Period Concept;
g. Accrual Concept;
h. Periodic Matching of Cost and Revenue Concept; and
i. Realisation Concept

Each of the Accounting Concepts is discussed below:

a. Entity Concept

For accounting purposes, an "organisation" is treated as a separate entity from the "owners" or "stakeholders". This concept helps in keeping private affairs of the owners and stakeholders separate from the business affairs. For example, an educational institutions is a separate, independent and autonomous entity and is governed by a separate legislation and the regulations formed by it. The various stakeholders of the educational institutions, including citizens, state government, environmentalists, etc., do not own the educational institutions. Thus, a separate balance sheet and income & Expenditure Statement are prepared in respect of the operations of the educational institutions. This concept is applicable to all forms of organisation.

b. Dual Aspect or Accounting Equivalence Concept

This concept follows from the Entity Concept. All entities own certain assets. Such assets are acquired through contributions of those who have provided the funds for the purpose. Funds are made available either through the surpluses of the entity or loans or payables. In a sense, such providers of funds are claimants to the assets. At any point of time, the assets will be equal to the claims. Since the claims on the assets could be those of "outsiders" (i.e. liabilities) or "owners" (i.e. capital, reserves, etc.), it results in the accounting equation:

Assets = Own Funds + Liabilities

c. Going Concern Concept

It is assumed that the organisation will continue for a long time, unless and until it has entered into a state of liquidation. It is as per this concept, that the accountant does not take into consideration the market value of the assets while valuing them, irrespective of whether the market value is higher or lower than the book value. Similarly, depreciation on fixed assets is provided on the basis of expected lives of the assets rather than on their market values. Also, the financial statements are prepared at defined period-end to measure the performance of the entity during that period and not only on the closure or liquidation of the entity.

d. Money Measurement Concept

In accounting, every transaction is recorded in terms of money. Events or transactions that cannot be expressed in terms of money are not recorded in the books of accounts. Receipt of income, payment of expenses, purchase and sale of assets, etc., are monetary transactions that are recorded in the books of accounts. For example, the event of a machinery breakdown is not recorded as it does not have a monetary value. However, the expenditure incurred for the repair of the machinery can be measured in monetary value and hence is recorded.

e. Cost Concept

As per this concept, an asset is ordinarily recorded at the price paid to acquire it, i.e., at its cost and this cost is the basis for all subsequent accounting for the asset. The cost concept does not mean that the asset will always be shown at cost. This basically signifies that each time the financial statements are prepared; the fixed assets need

not be revised and recorded at its realisable or replacement or market value. The assets recorded at cost at the time of purchase may systematically be reduced through depreciation.

f. Accounting Period Concept

An accounting period is the interval of time at the end of which the financial statements are prepared to ascertain the financial performance of the organisation. Although the "going concern" concept stresses the continuing nature of the entity, it is necessary for an organisation (e.g. educational institutions) to review how it is performing. The preparation of financial statements at periodic intervals helps in taking timely corrective actions and developing appropriate strategies. The accounting period is normally considered to be of twelve months.

g. Accrual Concept

Under the cash system of accounting, the revenues and expenses are recorded only if they are actually received or paid in cash, irrespective of the accounting period to which they belong. But under the accrual concept, occurrence of claims and obligations in respect of incomes or expenditures, assets or liabilities based on happening of any event, passage of time, rendering of services, fulfillment (partially or fully) of contracts, diminution in values, etc., are recorded even though actual receipts or payments of money may not have taken place. In respect of an accounting period, the outstanding expenses and the prepaid expenses and similarly the income receivable and the income received in advance are shown separately in the books of accounts under the accrual method.

h. Periodic Matching of Cost and Revenue Concept

To ascertain the surplus or deficit made by the entity during an accounting period, it is necessary that the costs incurred are matched with the revenue earned by the entity during that accounting period. The matching concept is a corollary drawn from the accrual concept. To ascertain the correct surplus or deficit, it is necessary to make adjustments for all outstanding expenses, prepaid expenses, income receivable and income received in advance to correctly depict and match the income and expenditure relating to that accounting period.

i. Realisation Concept

According to this concept, revenue should be accounted for only when it is actually realised or it has become certain that the revenue will be realised. This signifies that revenue should be recognised only when the services are rendered or the sale is affected. However, in order to recognise revenue, actual receipt of cash is not necessary. What is important is that the organisation should be legally entitled to receive the amount for the services rendered or the sale affected.

Accounting Conventions used in Double Entry Accounting System on accrual basis

Accounting Conventions are the customs or traditions guiding the preparation of accounts. They are adopted to make financial statements clear and meaningful. The Accounting Conventions are as follows:

a. Convention of Disclosure;
b. Convention of Materiality;
c. Convention of Consistency; and
d. Convention of Conservatism.

Each of the accounting conventions are discussed below.

a. Convention of Disclosure

The term "disclosure" implies that there must be a sufficient revelation of information which is of material interest to owners, creditors, lenders, investors, citizens and other stakeholders. The accounts and the financial statements of an entity should disclose full and fair information to the beneficiaries in order to enable them to form a correct opinion on the performance of such entity, which in turn would allow them to take correct decisions. For example, the Accounting Principles that have been followed for preparation of the Financial Statements should be disclosed along with the Financial Statements for proper understanding and interpretation of the same.

b. Convention of Materiality

An item should be regarded as material, if there is a sufficient reason to believe that knowledge of it would influence the decision of informed creditors, lenders, investors, citizens and other stakeholders. The accounts and the financial statements should impart importance to all material information so that true and fair view of the state of affairs of the entity is given to its beneficiaries. Hence, keeping the convention of materiality in view, unimportant items are not disclosed separately and are merged with other items. For example, the expenditure incurred on repairs and maintenance of a certain asset of the educational institutions, which are small, may not be disclosed separately in respect of each such small item but may be grouped together and shown as a single item of expenditure.

c. Convention of Consistency

The convention of consistency facilitates comparison of financial performance of an entity from one accounting period to another. This means that the accounting principles followed by an entity should be consistently applied by it over the years. For example, an organisation should not change its method of depreciation every year, i.e., from Straight Line Method to Written Down Value Method or vice-versa. Similarly, the method adopted for valuation of stocks, viz., First in First Out (FIFO) or Weighted Average should be consistently followed. In case a change is made, it should be disclosed.

d. Convention of Conservatism

As per this convention, the anticipated profits should be ignored but all anticipated losses should be provided for in the books of accounts of an entity. This means that all prospective losses are taken into consideration, however, no doubtful income is taken into consideration in recording of transactions by an entity. For example, while provision for doubtful debts and discount is made on debtors or Accounts Receivables, no provision is made for likely discount receivable from creditors or Accounts Payables. Similarly, provision is made for diminution in value of investments; however, no provision is made for any appreciation in value of investments

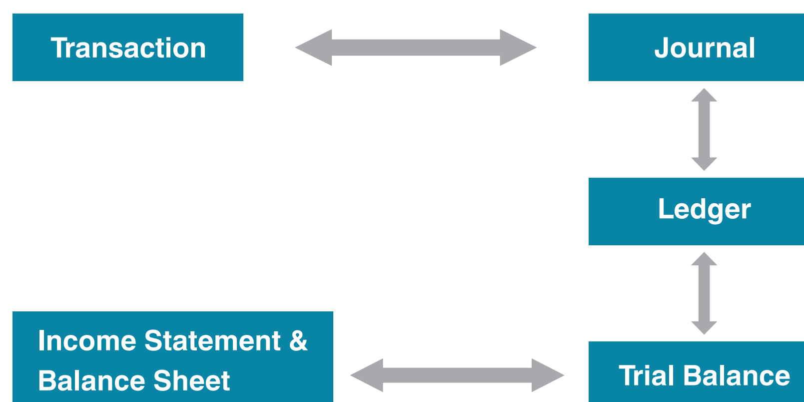
Double Entry Accounting System

Accounting

Accounting may be defined as the process of recording, classifying, summarising, analysing and interpreting the financial transactions and communicating the results there of to the persons interested is such information: Accounting is needed to answer the following questions.

i. What is owned?
ii. What is owed?
iii. Whether surplus or deficit on account of running of operation?
iv. What is the financial position i.e. ascertaining the entity would be in a position to meet all its commitments in future?

Accounting Process



Recording	Journal
Classifying	Ledger
Summarising	Trial Balance, Income Statement and Balance Sheet

Double Entry Accounting System

Double Entry Accounting System recognizes that every transaction has a dual effect. There are two sides of every transaction. If one account is debited, any other account must be credited. Every transaction affects at least two accounts in opposite directions. It may, however be noted, that the double entry does not mean that a transaction is recorded twice. But it means that at least two accounts are affected by a transaction one account receiving a benefit and other account yielding a benefit. It is because of dual aspect principle that the two sides of the Balance Sheet are always equal and the following accounting equation will always hold goods at any point of time.

Assets = Liabilities + Capital (or Net Worth)
Or
Capital (or Net Worth) = Assets – Liabilities

Whenever a transaction is to be recorded, it has to be recorded in two or more accounts to balance the equation. If a transaction affects (increases or decreases) the one side of equation, it will also affect (increase or decrease) the other side of equation or increase one account and decrease another account on the same side of equation. Equation remains balanced whenever a transaction takes place. E.g. Mr. A commences a business with Rs. 5 Lacs in cash and takes a loan of Rs. 1 Lacs from bank, and this Rs. 6 Lacs are used in buying some assets say plant & machinery,

The equation will be as follows:
Assets = Liabilities + Capital
Rs. 6 Lakh = Rs. 1 Lakh + Rs. 5 Lakh

S.No.	Transaction	Accounts affected	
		Assets	**Liabilities & Capital**
1	Capital brought in	Cash increases	Capital increases
2	Purchase Goods for Cash	Cash decreases Stock increases	
3	Purchase Goods on Credit	Stock increases	Creditors increase
4	Purchase Furniture for Cash	Furniture increases Cash decreases	
5	Paid Rent	Cash decreases	Rent = Expenses Therefore Capital decreases
6	Received Interest	Cash Increases	Interest = Income Therefore Capital increases
7	Sold Goods on Credit for Rs. 40,000 costing Rs. 30,000	Debtors increase by Rs. 40,000 Stock decreases by Rs. 30,000	Capital increases by Rs. 40,000 - 30,000 = Rs. 10,000
8	Paid to Creditors	Cash decreases	Creditors decrease

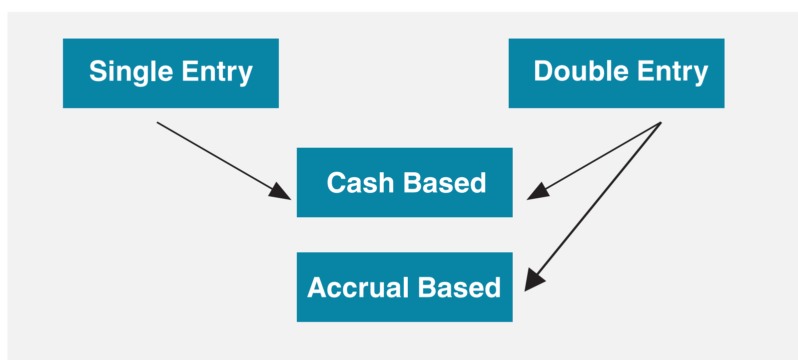
Account

An Account is a record of all business transactions relating to a particular person or item. In accounting, separate record of each individual, asset, liability, expenses or income is kept.

All accounts are divided into two sides. The left side of an account is arbitrarily or traditionally called Debit side and the right side of an account is called Credit side. In the abbreviate form, Debit is written as Dr. and Credit is written as Cr.

Accrual Based Double Entry Accounting System

Different Accounting Systems and Basis of Accounting



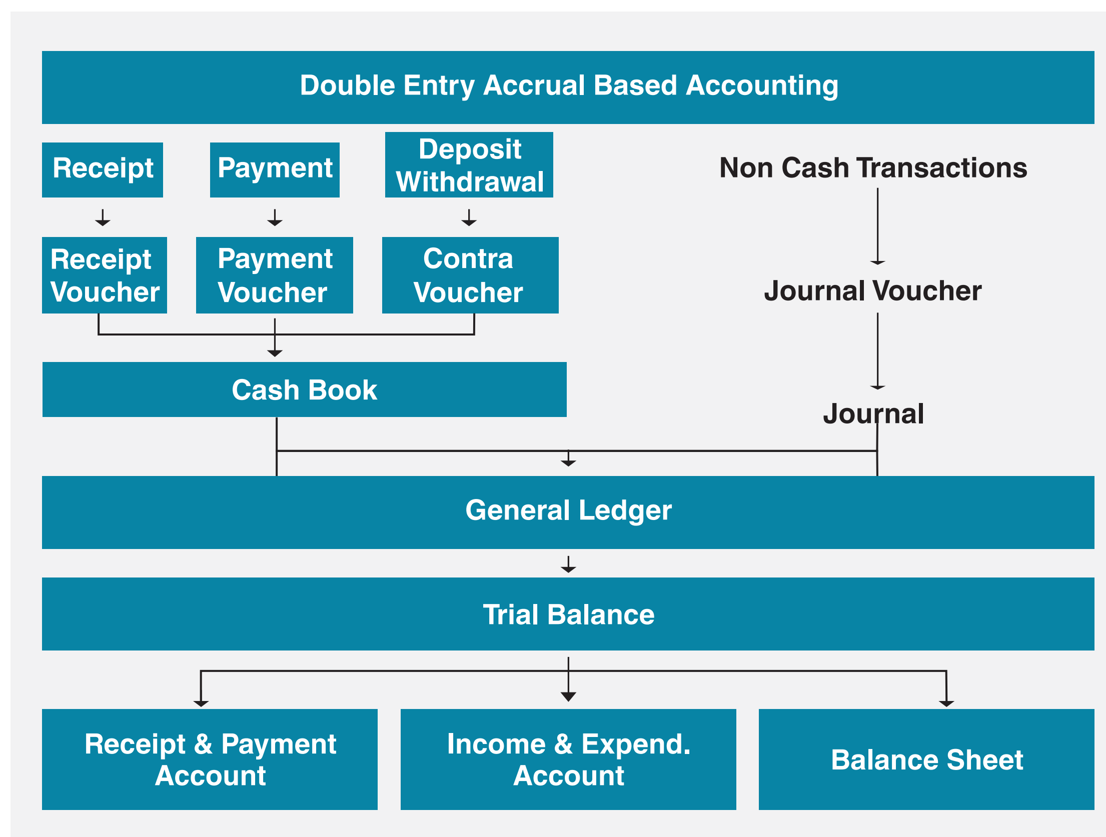
Difference Between Cash Based Single Accounting and Accrual Based Double Entry Accounting

Basis of Distinction	Single Entry Cash Basis of Accounting	Double Entry Accrual Basis of Accounting.
Nature of Transaction	All receipts and payments during the Accounting Period are recorded whether or not the transactions actually belong to that accounting period.	All income and expenses relating to the Accounting Period are recorded, whether or not received or paid actually.
Accounts	Only personal accounts and Cash Book are opened	Personal, Real and nominal accounts are opened.
Accuracy of Results	Accuracy of transactions cannot be verified since all transactions are recorded on single entry basis and no trial balance is prepared	All transactions are recorded based on double entry book-keeping, a trial balance is prepared to check the arithmetical accuracy of the transactions.
Financial performance	Only Receipt and Payment account is prepared, hence financial performance	Financial performance of an entity can be ascertained by preparing the

	cannot be ascertained as Income and Expenditure account is not prepared	Income and Expenditure Statement.
Financial Position	Only a Statement of Affairs is prepared which does not give the true and fair statement of affairs.	A Balance Sheet is prepared on going concern* basis which gives a true and fair state of affairs.
Authenticity	This system is not considered authentic by the Financial Institutions, lending agencies and other outside bodies.	This system of accounting is well accepted by the Financial Institutions, lending agencies and all other outside bodies.

Going Concern Concept: This concept is used when it is assumed that the organisation will continue for a long time, unless and until it has entered into state of liquidation. Therefore, the market value of the assets is not taken into considerations irrespective of the whether the market value is higher or lower than the book value. Similarly depreciation on fixed assets is provided on the basis of expected lives of the assets rather than on their market values. Also, the financial statements are prepared at defined period end to measure the performance of the entity during that period and not only on closure or liquidation of the entity

Accrual Based Double Entry Accounting Process



Classification of Accounts under Accural Based Double Entry Accounting System

Traditional classification of accounts

The classification of accounts according to Traditional Approach is given below:

Type of Account	Meaning	Example
Personal Account	These accounts relate to natural person, artificial person and representative person.	Contractor account(Natural), assesses account (Natural), employees account (Natural), loans from bank (artificial) advance deposits to tax authorities(artificial)
Real Account	Real accounts refer to those accounts of assets and properties, (both tangible and intangible) which an entity owns and has a legal claim on the assets and properties.	Tangible: Land, Building and other Infrastructure. Plants and Machinery, Cash, bank balance, stores and inventories investments. etc. Intangible: Trademarks, Goodwill
Nominal Account	These accounts relate to expenses, income, gains, and losses.	Property Tax (Income), license fees (Income), establishment charges (Expenses), repair and maintenance (expenses), liabilities no longer payable (Gains), tax dues waived (Loss) etc.

Accounting Equation Based Classifications of Accounts

The classification of accounts, accounting to 'Accounting Equation' approach is given below:

Type of Account	Meaning	Example
Asset Account	These accounts relate to tangible and intangible real assets	Tangible: Land, Building, Machinery, etc. Intangible: Trademarks, Goodwill
Liability Account	These accounts relate to the financial obligations of an organization towards	Salaries payable, creditors, outstanding expenses, bank

	outsiders.	overdrafts, short terms/ long term borrowings. etc.
Capital Fund	These account relate to owners of the organization	Educational Institutions funds

The equation is always:

Assets = Liabilities + Capital

or

Liabilities = Assets – Capital

or

Capital = Assets - Liabilities

Golden Rules of Debits & Credits

Traditionally Debits are written on the left side of the accounts and Credits on the right side of the account. The golden rules of debit and credit are as under:-

In case of traditional accounts

Type of Account	Debit	Credit
Personal Account	Benefit Receiver	Benefit Giver
Real Accounts	Which comes in	Which goes out
Nominal Account	Expenses and Losses	Incomes and Gains

In case of Equation accounts

Type of Account	Debit	Credit
Capital Account	Decrease	Increase
Liability Account	Decrease	Increase
Assets	Increase	Decrease

Understanding Debits & Credits

The term debit should not be taken to mean favorable things. It may represent favorable or unfavorable, increase or decrease depending on the nature of an account. Similarly, term credit may represent favorable or unfavorable,

increase or decrease depending on the nature of the concerned account. In the case of assets and expenses, debt means increase; credit means decrease in assets and expenses. In the case of liabilities capital and incomes, debit means decrease and credit represents increase.

Some basic things to remember about Debit and Credit are:

- Debits and Credits can be considered as pluses (+) and minuses (-). Hence 'debiting' an account means increasing the pluses while 'crediting' an account means increasing the minuses;

- Every financial transaction will affect at least 2 accounts - they will be debited and credited such that the debits will be equal to the credits. In other words, the sum of pluses and minuses will be zero;

- Some accounts are 'plus' or debit nature accounts. In order to increase them, they must be debited. Examples include cash, bank, payments and asset accounts. For example If Rs.100 is received in cash, the cash account is to be 'debited' to increase the cash balance;

- Other accounts are 'minus' or credit nature accounts. Here, in order to increase them, the account must be credited. Examples include various income and liability accounts. Hence, if the Rs.100 received above is on account of house tax, the House Tax account is to be 'credited' to record the increase in income. As a result of this, debit = credit i.e. the entry is complete;

- 'Plus' nature accounts can be 'credited' to reduce their balance and similarly, 'Minus' nature accounts can be 'debited' to reduce their balance. For ex. if Rs.30 is paid as wages out of the Rs.100 received above, the accounts affected are i) wages account (payment type, which is a 'plus' account) and ii) cash account (asset type, which is also a 'plus' account). However, since cash is going out, the cash account needs to be reduced by credit and wage account needs to be increased by debit of Rs.30 each thus completing the entry;

- The balance at the end of each period is calculated by netting all the debits and credits of each account. If the debits are more it is called a 'debit balance' and similarly if credits are more it is called a 'credit balance' account. For ex. in the above example, cash account will have a net debit balance of 100-30 i.e. Rs.70, House Tax will have a credit balance of Rs.100 and Wages will have a debit balance of Rs.30. In sum, all the debits (Rs.100) = all the credits (Rs.100);

Rules of Debit and Credit

In order to decide when to write on the debit side of an account and when to write on the credit side of an account it depends on the nature of an account. For this purpose, all the accounts are classified into the following five categories

I. Assets Accounts
II. Liabilities Accounts
III. Capital Account or Owner's Equity Account
IV. Revenue or Income Accounts
V. Losses or Expenses Accounts

Accordingly, following rules of debit or credit in respect of the various categories of accounts can be obtained:-

I. Assets Accounts: - When there is an increase in the amount of an asset, such an increase is recorded on the debit side of the asset account and if there is a reduction in the amount of an asset, such reduction is recorded on the credit side of the asset account. For example, if a firm purchases furniture of Rs. 5,000, it will be recorded on the debit side of the furniture account, since the furniture has increased by this amount. Again, if the firm sells furniture of Rs. 2,000, the reduction will be recorded on the credit side of the furniture account.

Dr. Asset Account Cr.

Increase in asset will be recorded on this side	Rs.	Decrease in asset will be recorded on this side	Rs.

II. Liabilities Accounts:- When there is an increase in the amount of a liability, such an increase will be recorded on the credit side of the liability account. Reversely, if there is a reduction in the amount of a liability, it will be recorded on the debit side of the liability account. For e.g. if a firm borrows Rs.10000 from Govind, the account of Govind will be credited since Rs.10000 is now owing to him. When the loan is repaid, the account of Govind will be debited since the liability no longer exists.

Dr. Liability Account Cr.

Decrease in liability will be recorded on this side	Rs.	Increase in liability will be recorded on this side	Rs.

III. Capital Account: - An increase in the capital is recorded on the credit side and the decrease in the capital is recorded on the debit side. Suppose, the proprietor introduces the additional capital in the business, the capital account will be credited. Similarly, if the proprietor withdraws some money for his personal use i.e., makes drawings, the capital account will be debited.

Dr. Capital Account Cr.

Decrease in capital will be recorded on this side	Rs.	Increase in capital will be recorded on this side	Rs.

IV. Revenue or Income Accounts: - All increases in the gains and incomes are recorded on the credit side of the concerned income account as it leads to increase in the capital. Reversely, if there is a reduction in any gain or income, the account concerned will be debited, as it leads to decrease in the capital.

Dr. Revenue or Income Account Cr.

Decrease in gains & incomes will be recorded on this side	Rs.	Increase in gains & incomes will be recorded on this side	Rs.

V. **Losses or Expenses Account: -** All increases in the losses and expenses are recorded on the debit side of the concerned expenses account as it leads to decrease in the capital. Reversely, the reduction in expenses is recorded on the credit side.

Dr. Losses or Expenses Account Cr.

Increase in losses & expenses will be recorded on this side	Rs.	Decrease in losses & expenses will be recorded on this side	Rs.

The rules given above may be summarized as below: -

1. **Debit the increase in Assets and Credit the decrease in Assets.**
2. **Credit the increase in Liabilities and Debit the decrease in Liabilities.**
3. **Credit the increase in Capital and Debit the decrease in Capital.**
4. **Credit the increase in Incomes and Debit the decrease in Incomes.**
5. **Debit the increase in Expenses and Credit the decrease in Expenses.**

The term debit should not be taken to mean favourable things. It may represent favourable or unfavourable, increase or decrease depending on the nature of an account. Similarly, the term credit may represent favourable or unfavourable, increase or decrease depending on the nature of the concerned account. In the case of assets and expenses, debit means increase, credit means decrease in assets and expenses. In the case of liabilities, capital and incomes, debit represents decrease and credit represents increase.

Source Documents of Accountancy

Documents on the basis of which entries are recorded in the books of accounts are named as 'Source Documents'. According to the verifiable objective principle of accounting, each transaction recorded in the books of account should have adequate proof to support it. These documents are the written and authentic proof of the correctness of the recorded transaction.

Vouchers

On the basis of source documents entries are first recorded on vouchers. Each voucher is divided in two parts - debit & credit. A serial number is put on each voucher and the relative source documents are attached with the voucher. The vouchers are properly filed according to their serial numbers so that the auditors may easily vouch them and these may also serve as documentary evidence in future.

Journal

Journal is a book of original entry in which the transactions are recorded first of all, as and when they take place. The journal provides a date-wise record of all the transactions with details of the accounts debited and credited, and the amount of each transaction.

Steps in Journalising

Before recording a journal entry, it is essential to analyse a transaction in order to determine the two accounts, which are affected. Then, on the basis of rules of journalising, it must be decided as to which account is to be debited and

which account is to be credited.

Rules of Journalising

The account to be debited or credited will be determined on the basis of following rules: -

1. **Personal Accounts:-** Debit the receiver and Credit the giver.
2. **Real Accounts:-** Debit what comes in and Credit what goes out.
3. **Nominal Accounts:-** Debit all Expenses and losses and Credit all Incomes and Gains.

Ledger

The book that contains a classified and permanent record of all the Transactions of a business is called the Ledger. It is the chief book of accounts, and it is in this book that all the business transaction would ultimately find their place under their accounts in duly classified form.

T form of Ledger

Dr. Ledger Account of... Cr.

	Rs.		Rs.

Each Ledger account is divided into two equal parts. The left-hand side is known as the debit side and the right-hand side as the credit side.

Performa of Ledger used in Commercial Enterprises for maintaining accounts manually

LEDGER BOOK

Ledger Account of

Date	Particulars	C.B. Folio	Debit		Credit		Dr. or Cr.	Balance	
			Rs.	P.	Rs.	P.		Rs.	P.

Rules of Posting

Posting is the process of transferring entries from Journal or Subsidiary Books to the Ledger. The following rules should be observed while posting entries in the Ledger: -

1. All transactions relating to an account should be entered at one place. In other words, two separate accounts should not be opened for posting transactions relating to the same account.

2. The word 'To' is used before the account which appears on the debit side of an account. Similarly, the word 'By' is used before the account which appears on the credit side of an account.

3. If an account has been debited in the Journal entry, the posting in the Ledger should also be made on the debit side of such account. In the Particular column, the name of the other account which has been credited in the Journal entry should be written for reference.

4. If an account has been credited in the Journal entry, the posting in the Ledger should also be made on the credit side of such account. In the Particular column, the name of the other account which has been debited in the Journal entry should be written for reference.

5. Similar amount which has been posted on the debit side of an account should also be posted on the credit side of another account.

Closing and Balancing of Accounts

At the end of the accounting period or whenever needed, the accounts are balanced. Balancing of an account means that the debit and credit sides are totalled and the difference between the two sides is inserted on the side which is shorter so as to make their totals equal. If the debit side exceeds the credit, the balance is called the debit balance and on the other hand, if the credit side exceeds the debit, the balance is called a credit balance.

Practical Problems

1. Exam fees received - Rs. 15 lakh

Cash at Bank	Dr	15,00,000	
To Exam Fees			15,00,000

Rule

Debit what comes in

Credit all income

2. Salary paid - Rs. 2 lakh

Salary	Dr	2.00,000	
To Cash at bank			2,00,000

Rule

Debit all expenses

Credit what goes out

3. Furniture purchased for (cash purchase) Rs. 1 lakh

Furniture	Dr	1,00,000	
To Cash at Bank			1,00,000

Rule

Debit what comes in

Credit what goes out

4. Computer purchased on credit Rs. 1.5 lakh

Computer	Dr	1,50,000	
To Creditor			1,50,000

Rule

Debit what comes in

Credit the giver

5. In entry no. 1 out of Rs 5 lakh, Rs. 1 lakh was on account of Hostel charges.

Exam Fees	Dr	1,00,000	
To Hostel Charges			1,00,000

Rule

Debit decrease in income

Credit all income

6. Interest for Rs. 1 lakh has become due but has not been received

Interest Receivable	Dr	1,00,000	
To Interest			1,00,000

Rule

Debit what comes in - right to get interest

Credit all income

7. Creditor for Computer paid Rs. 1 lakh

Creditor	Dr	1,00,000	
To Cash at Bank			1,00,000

Rule

Debit the receiver

Credit what goes out

8. Money received from Alumini for construction of road - Rs. 100 lakh

Cash at Bank	Dr	10,00,000	
To Advance - Alumini			10,00,000

9. Work for CC pavement awarded to M/s X & Co.

No Entry

10. M/s X & Co. completes the work, work is certified and bill is passed for Rs. 3 lakh (Security Deposit Rs. 30,000, TDS Rs. 15,000, Work Tax Rs. 10,000)

CC Pavement	Dr	3,00,000	
To Security Deposit			30,000
To TDS - Contractor			15,000
To Work Tax			10,000
To M/s X & Co.			2,45,000

11. Cash Withdrawn from bank Rs. 5 lakh

Cash in hand	Dr	5,00,000	
To Cash at Bank			5,00,000

12. Permanent Imprest issued to Mr. A Rs. 50,000

Permanent Imprest-Mr. A	Dr	50,000	
To Cash at Bank			50,000

13. Mr. A submit bills and permanent imprest recouped

Stationery	Dr	15,000	
Running & Maint. of Vehicles	Dr	30,000	
To Permanent Imprest - Mr. A			45,000
Permanent Imprest - Mr. A	Dr	45,000	
To Cash at Bank			45,000

14. Salary bill for Mr. B passed for Rs. 25,000. Deduction on account of GPF & TDS to be made for Rs. 3,000 & Rs. 2,000 respectively payment made.

Pay & Allowance	Dr	25,000	
To GPF			3,000
To TDS-Salary			2,000
To Salary Payable			20,000
Salary Payable	Dr	20,000	
To Cash at Bank			20,000

Workshop 1

1. Write the category of following account heads (Asset, Liability, Expense or Income)

S.No.	Account Head	Category
1.	Building	
2.	Hostel Charges	
3.	Exam Fees	

4.	Library Fees receivables	
5.	Salary	
6.	Playground	
7.	GPF	
8.	GIS	
9.	Car Parking Fees	
10.	Common Room Fees	
11.	Rent From Cooperative Stores	
12.	Building	
13.	Postage	
14.	Statues	
15.	Rent from Hoarding Space	
16.	Telephone Expenses	
17.	Newspaper and Periodicals	
18.	Dearness Pay	
19.	Sale of Books	
20.	Hired Cars	
21.	Stamps	
22.	Auditorium	
23.	Consultation Expenses	
24.	Earnest Money Deposit	
25.	House Building Allowance	
26.	Fees From License	
27.	Oils, Lubricants and Fuel	
28.	Conveyance Advance	
29.	Xerox Machine	
30.	Interest on Advances to Employees	
31.	LTC	
32.	Medicines	
33.	Deprecation	
34.	Software	
35.	Canteen Expenses	
36.	Computer	
37.	Write off-Furniture	
38.	Electricity Charges	

39.	Security Deposit	
40.	Cash	
41.	Bank	

2. What is the difference between accrual based accounting and cash based accounting?

3. In which basis of accounting current assets and current liabilities arise?

4. What is the difference between current asset and fixed asset?

5. What is the difference between long term liabilities and current liabilities?

6. What is the difference between fixed asset and capital work in progress?

7. What are the main sources of income for Educational bodies and how will you collect data about these sources?

8. Identify the sources where income is received in advance and source where arrears are there

Workshop 2

1. Rent received - Rs. 50,000

2. Cash deposited in to bank - Rs. 80,000

3. Salary paid to Ram. Gross salary Rs. 30,000. Deductions made on account of GPF Rs. 4,500, TDS Rs. 2,500, Conveyance Advance Rs. 1,000. Balance paid in to his bank account

4. Computer purchased for Rs. 1,00,000

5. Furniture purchased for Principal Office Rs. 2,00,000

6. Amount transferred in to Fixed Deposit Receipt from bank Account for Rs. 80 lacs on 1 October 2010 @ 12% p.a. (Interest payable on 31 December and 30 June every year with out any compounding)

7. Pass entry for receipt of interest on FDR in Problem No. 6 on 31 December 2010

8. Pass entry for accrual of interest on FDR in Problem No. 6 on 31 March 2011

9. Pass entry for receipt of interest on FDR in Problem No. 6 on 30 June 2011

10. Plant & Machinery purchased on credit from M/s. XYZ Ltd. on credit for Rs. 4 lacs

11. TDS on salary deducted in Problem No. 3 is deposited in to Government treasury.

12. Loan taken from ABC Bank for Rs. 50 lacs on 1 July 2006 @ 10% p.a. Interest payable on 31 December and 30 June every year.

13. Pass entry for payment of interest on Loan in Problem No. 12 on 31 December 2006

14. Pass entry for accrual of interest on Loan in Problem No. 12 on 31 March 2007

15. Pass entry for payment of interest on Loan in Problem No. 12 on 30 June 2007

16. First running bill passed for Construction of Building for Rs. 15 lacs. Security Deposit Rs. 50,000 and TDS Rs. 75000. The balance paid at the time of passing of bill to contractor.

17. Second running and final bill passed for the same building (in Problem No. 16) for Rs. 30 lacs. Security Deposit Rs. 1,00,000 and TDS Rs. 1,50,000. Balance paid.
    i.

ii.

18. TDS deducted in Problem nos. 16 and 17 deposited in to Government treasury

19. Rent in Problem 1 is actually on account of Sale of tender fees. Pass rectification entry.

20. Security Deposit refunded for Rs. 50,000

21. Loan installment paid for Rs. 10 lacs

22. FDR in Problem No. 6 matured (no accrued interest) and reinvested in to Debentures

    i.

    ii.

23. Retirement benefits paid. Earned leave Rs. 3 lacs, Commuted Pension Rs. 4 lacs

24. First running bill, second running bill and third running bill passed and paid for the work of construction of Buidling on 1 May 2006 for Rs. 50 lacs, on 1 September 2006 for Rs. 60 lacs and on 1 November 2006 for Rs. 100 lacs respectively. The deductions from each bill are Security deposit @ 5% of bill amount and TDS @ 10% of bill amount. Pass entries on respective dates.

    i.

    ii.

    (iii)

25 The fourth and final bill passed for the work of construction of Building in Problem No. 24 for Rs. 120 lacs on 28 March 2007 and paid. Security deposit and TDS were deducted at the same rate as in Problem No. 24. Pass entries.

i.

ii.

Generation of Trial Balance and Preparation of Financial Statements

Trial Balance

Trial balance is a statement, prepared with the debit and credit balances of Ledger accounts to test the arithmetical accuracy of the books.

When posting of all the transactions into the Ledger is completed and the accounts are balanced off, it becomes necessary to check the arithmetical accuracy of the accounting work. For this purpose, the balance of each and every account in the Ledger is put on a list. The list so prepared is called a trial balance.

Ledger account, which shows a debit balance, is put on the debit side of the trial balance and the account, which shows a credit balance is put on the credit side of the trial balance. Account, which shows no balance i.e. whose debit and credit totals are equal, is not entered in the trial balance. If the total of the debit side of trial balance equals to that of its credit side, it is proved that books are at least arithmetically correct and there are no errors in the posting and balancing the Ledger accounts.

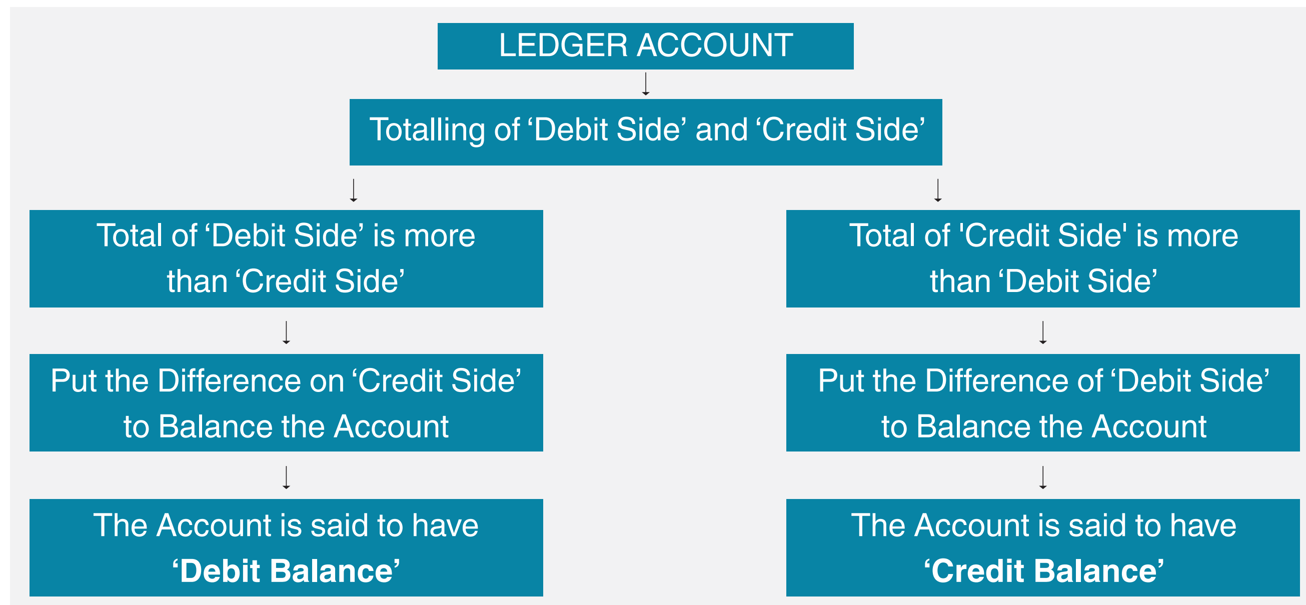
Steps for preparation of Financial Statements

For preparation of financial transactions following steps should be followed-

i. **Balancing of Accounts**

   The first step in preparation of financial statements is 'Balancing of Accounts'. This step is carried after all the transactions are accounted. In order to balance an account, the two sides, namely Debit and Credit are totaled up separately and the difference is ascertained.

   If Debit Side of an account is heavier than the Credit Side, the account is said to have Debit Balance and if Credit Side of an account is heavier than the Debit Side, the account is said to have Credit Balance. It could be understood as under -



This difference is put on the side that is lower to balance the two sides of an account.
For Example -

a. Following is a ledger account of Computer Desktops containing all the transactions entered during the reporting period 1st April 2007 to 31st March 2008.

Date	Particulars	Debit (Rs)	Date	Particulars	Credit (Rs)
5/4/2007	To Bank A/c	50,00,000			
12/12/2007	To Bank A/c	25,00,000			
3/3/2007	To Bank A/c	20,00,000			
	Total	**95,00,000**		**Total**	**Nil**

The total of Debit Side is Rs.95,00,000/- and total of Credit Side is Nil. The Difference between total of debit side and total of credit side is Rs.95,00,000/-. Hence, Debit side of this account viz. Computer Desktops A/c is heavier than the Credit Side by Rs.95,00,000/-. Hence, the said account is balanced by putting the difference amount on the credit side (as the credit side is lower) on the last day of the reporting period, as under -

Date	Particulars	Debit (Rs)	Date	Particulars	Credit (Rs)
5/4/07	To Bank A/c	50,00,000	31/3/07	By Closing Balance	95,00,000
12/12/07	To Bank A/c	25,00,000			
3/3/07	To Bank A/c	20,00,000			
	Total	**95,00,000**		**Total**	**95,00,000**

Since Debit side of this account is heavier than the credit side, this account is said to have 'Debit Balance'.

a. Following is a ledger account of EMD & Security Deposits containing all the transactions entered during the reporting period 1st April 2007 to 31st March 2008.

Date	Particulars	Debit (Rs)	Date	Particulars	Credit (Rs)
15/5/07	To Bank A/c (EMD Refunded)	2,00,000	5/4/07	By Bank A/c (EMD Received)	10,00,000
31/7/07	To Bank A/c (EMD Refunded)	2,00,000	30/6/07	By pavements A/c (SD Deducted from the Bill)	30,00,000
3/3/07	To Bank A/c (SD Refunded)	10,00,000	30/7/07	By Water Treatment Plant A/c (SD Deducted from the Bill)	50,00,000
	Total	**14,00,000**		**Total**	**90,00,000**

The total of Debit Side is Rs.14,00,000/- and total of Credit Side is Rs.90,00,000/-. The Difference between total of debit side and total of credit side is Rs.76,00,000/-. Hence, Credit Side of this account viz. Computer Desktops A/c is heavier than the Debit Side by Rs.76,00,000/-. Hence, the said account is balanced by putting the difference amount on the Debit Side (as the Debit Side is lower) on the last day of the reporting period, as under -

Date	Particulars	Debit (Rs)	Date	Particulars	Credit (Rs)
15/5/07	To Bank A/c (EMD Refunded)	2,00,000	5/4/07	By Bank A/c (EMD Received)	10,00,000
31/7/07	To Bank A/c (EMD Refunded)	2,00,000	30/6/07	By pavement A/c (SD Deducted from the Bill)	30,00,000

3/3/07	To Bank A/c (SD Refunded)	10,00,000	30/7/07	By Water Treatment Plant A/c (SD Deducted from the Bill)	50,00,000
31/3/07	To Closing Balance	76,00,000			
	Total	**90,00,000**		**Total**	**90,00,000**

Since the Credit Side of this account is bigger than the Debit side this account is said to have credit balance.

b. Following is a ledger account of Salary containing all the transactions entered during the reporting period 1st April 2007 to 31st March 2008.

Date	Particulars	Debit (Rs)	Date	Particulars	Credit (Rs)
30/4/07	To Bank A/c (April 2007)	2,00,000			
31/5/07	To Bank A/c (May 2007)	2,00,000			
30/6/07	To Bank A/c (June 2007)	2,00,000			
31/7/07	To Bank A/c (July 2007)	2,00,000			
31/8/07	To Bank A/c (Aug 2007)	2,00,000			
30/9/07	To Bank A/c (Sep 2007)	2,00,000			
31/10/07	To Bank A/c (Oct 2007)	2,00,000			

30/11/07	To Bank A/c (Nov 2007)	2,00,000			
31/12/07	To Bank A/c (Dec 2007)	2,00,000			
31/1/08	To Bank A/c (Jan 2008)	2,00,000			
28/2/08	To Bank A/c (Feb 2008)	2,00,000			
31/3/08	To Bank A/c (Mar 2008)	2,00,000			
	Total	**24,00,000**			

The total of Debit Side is Rs.24,00,000/- and total of Credit Side is Nil. The Difference between total of debit side and total of credit side is Rs.24,00,000/-. Hence, Debit side of this account viz. Salary A/c is heavier than the Credit Side by Rs.24,00,000/-. Hence, the said account is balanced by putting the difference amount on the credit side (as the credit side is lower) on the last day of the reporting period, as under -

Date	Particulars	Debit (Rs)	Date	Particulars	Credit (Rs)
30/4/07	To Bank A/c (April 2007)	2,00,000	31/3/08	By Closing Balance	24,00,000
31/5/07	To Bank A/c (May 2007)	2,00,000			
30/6/07	To Bank A/c (June 2007)	2,00,000			

31/7/07	To Bank A/c (July 2007)	2,00,000			
31/8/07	To Bank A/c (Aug 2007)	2,00,000			
30/9/07	To Bank A/c (Sep 2007)	2,00,000			
31/10/07	To Bank A/c (Oct 2007)	2,00,000			
30/11/07	To Bank A/c (Nov 2007)	2,00,000			
31/12/07	To Bank A/c (Dec 2007)	2,00,000			
31/1/08	To Bank A/c (Jan 2008)	2,00,000			
28/2/08	To Bank A/c (Feb 2008)	2,00,000			
31/3/08	To Bank A/c (Mar 2008)	2,00,000			
	Total	**24,00,000**		**Total**	**24,00,000**

Since the Debit Side of this account is heavier than the Credit side this account is said to have Debit balance.

ii. Preparation of Trial Balance

After Balancing of all the accounts, a listing of all the accounts is prepared with their respective balances in a specific format, which is known as a 'Trail Balance'. Trial Balance is usually prepared in the following format -

Sr. No.	Ledger Name	Debit Balance (Rs)	Credit Balance (Rs)
	Total		

In case of accounts having 'Debit Balance', their balances are entered in the column of 'Debit Balance' against their respective ledger names. While those accounts having 'Credit Balance', their balances are entered in the column of 'Credit Balance' against their respective ledger names.

However, the total of the trial balance viz. total of the column 'Debit Balance' shall be equal to the total of the column 'Credit Balance' because -

1. Trial Balance contains the balances of all the ledger accounts. AND

2. Every accounting entry passed, is made on the principal that - Every amount of Debit has an equal amount of Credit and every amount of Credit has an equal amount of Debit.

When the trial balance tallies i.e. when the total of the debit side of the trial balance is equal to the total of credit side, it shows arithmetical accuracy of the books of account. However, it does not mean that there are no any accounting errors in the books of account.

iii. Preparation of Income and Expenditure Statement

In order ascertain the result of operations i.e. profit earned or loss suffered for a given reporting period, we need to map the income earned during the reporting period against the expenses incurred during that period. Income and Expenditure Statement shows the result from the operation. It may be noted that Income and Expenditure Statement is also a ledger account. After preparation of trial balance, balances of all the ledger accounts of revenue income and revenue expenses are transferred to the Income and Expenditure Account by passing a journal entry. Revenue Expense Accounts which have debit balance are credited and Income and Expenditure Account is Debited. While Revenue Income Accounts which have credit balance are debited and Income and Expenditure A/c is Credited.

For Example -

To transfer the debit balance of Rs.24,00,000/- of Salary Account, the following entry is passed -

Date - 31/3/2008

Income and Expenditure Account Debit Rs.24,00,000

To Salary Account Credit Rs.24,00,000

For Example -

To transfer the credit balance of Rs.18,00,000/- of Fees Account the following entry is passed -

Date - 31/3/2008

Fees Account Debit Rs.18,00,000

To Income and Expenditure Account Credit Rs.18,00,000

After transferring all the ledger accounts of income and expenses to the Income and Expenditure Account, it is balanced like a ledger account. If the Income and expenditure account is having credit balance it means there is surplus. If the Income and expenditure account is having debit balance there is deficit. Income and Expenditure Statement is usually prepared in a 'T' form having 'Debit Side' and 'Credit Side' as under -

Income and Expenditure Account for the period ended

Debit Side **Credit Side**

Expenses	Amount (Rs)	Income	Amount (Rs)
All Accounts of Expenses		All Accounts of Income	
Total		**Total**	

iv. Preparation of Balance Sheet

It is a statement of affairs of an enterprise, which shows the net worth and financial standing of an enterprise. It has two sides viz. 'Liabilities' side and 'Assets' side. It may be noted that Balance Sheet is not a ledger account. It is a point statement showing the balances of all the assets owned by an enterprise and all the liabilities due from an enterprise and accumulated surplus of the enterprise 'as on' the last date of the reporting period i.e. the reporting date. Balance Sheet can be compared to a photograph it is only for that specific time hence written as “as on ”. Hence, no any entries are made to prepare the balance sheet. Balance Sheet is a presentation of the balances of all the accounts of Assets and Liabilities as on the reporting date. It also shows the balance of accumulated surplus of an enterprise as on the reporting date.

Following is a standard format of a Balance Sheet -
Balance Sheet as on

Liabilities	Amount (Rs)	Assets	Amount (Rs)
Reserves & Surplus		**Other Assets**	
Earmarked Funds		**Fixed Assets**	
Secured Loans		**Investments**	
Unsecured Loans		**Current Assets Loans & Advances**	
Current Liabilities			
Total		**Total**	

Workshop 3

1. Prepare the Income & Expenditure Account and Balance Sheet from the following Trial Balance.

Trial Balance

Account-heads	Category	I & E / BS	Debit	Credit
Building			50,000,000	
Car			20,000,000	
TD Contractors				2,000,000
VAT				5,000,000
Accounts Payable				45,000,000
Cash at Bank			570,000	
Internet Expenses			200,000	
Fees				5,000,000
Fees Arrears			200,000	
Fund Balance				8,000,000
Salary			2,500,000	
Examination Fees				8,470,000
Total			**73,470,000**	**73,470,000**

Income & Expenditure Account of ……. Educational Institution
For the year ending 31 March 2007

Expenses	Rs.	Income	Rs.

Balance Sheet of ……. Educational Institution
As on 31 March 2007

Liabilities	Rs.	Assets	Rs.

2. Prepare the Income & Expenditure Account and Balance Sheet from the following Trial Balance

Trial Balance

Account-heads	Category	Debit	Credit
Building		30,000,000	
Cars		20,000,000	
Audtorium		100,000,000	
CWIP - Building		10,000,000	
CWIP - Auditorium		5,000,000	
TDS Contractors			3,000,000
VAT			3,000,000
Security Deposit			4,000,000
Salary Payable			1,000,000
Retirement Benefits Payable			3,000,000
Accounts Payable			55,000,000
Loans			70,000,000
Accrued Interest			1,600,000
Cash at Bank		770,000	
Internet Expenses		600,000	
Fees			8,000,000
Fees Arrears		200,000	
Fund Balance			12,000,000
Salary		2,500,000	
Water Tax			8,470,000
Total		**169,070,000**	**169,070,000**

Income & Expenditure Account of ……. Educational Institution
For the year ending 31 March 2007

Expenses	Rs.	Income	Rs.

Balance Sheet of ……. Educational Institution
As on 31 March 2007

Liabilities	Rs.	Assets	Rs.

3. Prepare the Income & Expenditure Account and Balance Sheet from the following Trial Balance

Trial Balance

Account-heads	Category	I & E / BS	Debit	Credit
Stadium			20,000,000	
Footpaths			50,000,000	
Roads			100,000,000	
Building			20,000,000	
Cars			10,000,000	

TDS Contractors				6,000,000
VAT				3,000,000
Security Deposit				4,000,000
Salary Payable				1,000,000
Electricity Bills Payable				800,000
Telephone Bills Payable				2,500,000
Mobile Bill Payable				900,000
Retirement Benefits Payable				4,000,000
Accounts Payable				40,000,000
Loans				90,000,000
Accrued Interest				1,800,000
Cash at Bank			970,000	
Internet Expenses			1,200,000	
Property Tax				42,000,000
Property Tax Arrears			200,000	
Fund Balance				12,000,000
Salary			2,500,000	
Fees				8,470,000
Accrued Interest on Investments			1,600,000	
Investments			10,000,000	
Total			**216,470,000**	**216,470,000**

Income & Expenditure Account of ……. Educational Institution
For the year ending 31 March 2007

Expenses	Rs.	Income	Rs.

Balance Sheet of ……. Educational Institution
As on 31 March 2007

Liabilities	Rs.	Assets	Rs.

New Chart of Accounts

1.0 Chart of Accounts is the listing of all the accounts in the general ledger with a unique account - code.

1.1 The chart of accounts is the framework for the general ledger system, and therefore the basis for the accounting system of Urban Local Bodies. The chart of accounts consists of group-head, sub group heads, account-heads and account code.

1.2 A 13 digit code shall be used
The first digit shall be 1.
The second and third digits shall be the code for function.
The fourth, fifth and sixth digits shall be the code for functionary/ geographical location (with in EDUCATIONAL INSTITUTIONS)/ scheme.
The seventh, eighth and ninth digit shall represent the major code:
Major code starting with digit 1 shall represent Income
Major code starting with digit 2 shall represent Expenses
Major code starting with digit 3 shall represent Liabilities & Capital
Major code starting with digit 4 shall represent Assets
The tenth and eleventh digits shall represent the minor code
The twelfth and thirteenth digits shall represent the detailed code

1.3 All the schemes will have the function code 99.

1.4 How to devise a code for new Body
The code for Body comprises 5 digits
The first two digits are the code for the district.
In case any new district is planned it can have the two digit code from 19-99.
The third digit is the code for type of Educational Institution.

University	1
Under Graduate College	2
Post Graduate College	3
Others	4

How to Prepare Opening Balance Sheet

Salient Points On Migration To Accrual Based Double Entry Accounting System

Introduction

This guidance document will help the Educational Institutions to understand the steps needed to be taken for switching to Accrual Based Double Entry Accounting System.

a. Preparation Of Opening Balance Sheet

The opening /first balance sheet forms the base for migration from Cash Based Single Entry Accounting System to Accrual Based Double Entry Accounting System. The preparation of the Opening Balance Sheet requires determination of balances of fixed assets and current assets, and long term and short term dues and liabilities payable. Opening Balance Sheet is required to be prepared to draw the educational institutions statement of affairs as on the date of the balance sheet and carrying the balances of all assets and liabilities to the next accounting year. Thus after the preparation of the opening balance sheet, conversion from cash based single entry accounting system to accrual based double entry accounting will take place.

Items to be Included in Opening Balance

- All owned assets or under permissive possession along with all liabilities (amounts payable) should be accounted for.

- No infrastructure covered under society, trust, co-op society etc. should be included in the assets.

- All entries shall be physically verified and supported by the documents.

- Assets handed over to the educational institutions should be accounted for only and should be valued at Rs.1/- if they have been transferred to the educational institutions without any consideration.

- Only that revenue which is measurable with fair chance of recovery should be included. Legally or otherwise disputed receivable shall not be included.

- Details of such court cases and measurable shall be disclosed in notes to accounts.

- Valuation shall be done on actual price paid/payable and no revaluation should be done.
- Capital cost of assets created out of government grant shall be taken into asset account and grant in liability account.

Valuation of Assets

- Original Cost less depreciation in cases where both cost and date of construction is available.
- In case cost is not available but date of construction/purchase is available :
  - i. Rs.1/- if asset has outlived its life.
  - ii. In case of building, at cost of construction of the relevant year of plinth area and depreciated till date of opening balance.
  - iii. In case cost of construction of the relevant year is not available than on the current cost of construction deflated to the year of construction based on wholesale price index and depreciated till date of opening balance.
  - iv. For other assets current replacement cost will be used and criteria of (iii) above applied.
- At Rs. 1/- in case neither cost nor date of construction is available.
- In case of land where original papers are not available the value may be ascertained failing which transaction value of the similarly situated plot.

Valuation of Fixed Assets

- Fixed assets should be recorded at cost including all ancillary costs.
- In case original cost can not be ascertained, the fixed asset having useful life of 20 years should be taken at the residual value of Rs. 1/-
- For parks and playgrounds the land including the cost of development should be included in the Land and other fixtures should be capitalized under 'parks and playgrounds'.
- Land acquired lease should be taken as asset at the total lease value for the entire lease period and amortized equally.
- Land purchased or acquired should be valued at price and incidental charges.
- Land acquired against tax dues shall be valued at finalized tax dues.
- Land received through donation should be valued at Rs.1/- but development charges if any shall be capitalized.

- Land acquired/purchased through govt. grants is valued at that cost and amount of grant will be shown as liability.

Depriciation

Written Down Value Method

Under this method, the rates of depreciation are applied at a fix rate on diminishing balance of the asset every year. i.e the depreciation is calculated on the remaining value of the asset after adjusting the Depreciation calculated so far for every year.

Straight Line Method

Under this method, the rates of depreciation are applied at a fixed rate, for the estimated life on the original cost of the Asset. i.e the depreciation amount remains the same for each year until there is no change in the life and cost of the asset. The depreciation is spread over the estimated life of the asset at a fixed rate.

The depreciation is charged for the estimated useful life of the asset, after considering the scrap value or salvage value of the assets

To use this method:

- Determine the asset's estimated useful life in years

- Determine the difference between:
  1. The asset's book value at acquisition
  2. The asset's expected scrap value (if any) at the end of its useful life

Divide this difference by the years of estimated useful life. Record this amount of depreciation during each fiscal year of the asset's estimated useful life.

Example

A vehicle was purchased on 1st April 2005 at a cost of Rs. 4, 50,000.00. The depreciation will be calculated in both the methods as follows:

The rate of Depreciation for WDV method will be 25.0% for the estimated life 10 years, while in SLM Method it will be 10.0%

Year	Written Down Value Method		Straight Line Method	
	Depreciation	Net Assets at the year end	Depreciation	Net Assets at the year end
2006	1,12,500.00	3,37,500.00	45,000.00	4,05,000.00
2007	84,375.00	2,53,125.00	45,000.00	3,60,000.00
2008	63,281.00	1,89,844.00	45,000.00	3,15,000.00
2009	47,461.00	1,42,383.00	45,000.00	2,70,000.00
2010	35,596.00	1,06,787.00	45,000.00	2,25,000.00

2011	26,697.00	80,090.00	45,000.00	1,80,000.00
2012	20,022.00	60,068.00	45,000.00	1,35,000.00
2013	15,017.00	45,051.00	45,000.00	90,000.00
2014	11,263.00	33,788.00	45,000.00	45,000.00
2015	8,447.00	25,341.00	45,000.00	0.00

This shows that in WDV Method a higher amount of Depreciation is being charged in initial years while later on it is very nominal. While in case of SLM method it remains same throughout the life of the asset

Items to be included in the Assets

1. Land and Building	Land & Buildings
2. Statues and Heritage	Statues and valuable works of arts and antiquities and heritage buildings.
3. Infrastructrure Assets	Playgrounds, light posts, and public lighting.
4. Plant & Machinery	Plants, machinery, equipments
5. Other Assets	Vehicles, office & other equipments, furniture and fixtures
6. Live Stock	
7. Intangible Assets	
8. Capital works in progress	
9. Long term investments	
10. Current Assets	Cash in hand, cash at bank, stores & spares, prepaid expenses, sundry debtors, interest on investments, interest on bank deposits, interests on loan and advances, recoverable deposits and receivable against deposit works.

Liablities to be included in the Opening Balance Sheet

1. Long Term Borrowings	
2. Short Term Borrowings	
3. Current liabilities	Bank overdraft, security deposits, retention money, earnest money, deposit works, other deposits, TDS and other taxes payable, advance collection of taxes and non taxes, accrued interest on loans, unpaid employees dues, unpaid electricity bills, contractors and suppliers bills payable.

Other Important Issues

Provision of doubtful debts:-

Provision of doubtful debts does no mean in waiver of taxes. However, amount so worked out will be reflected in the balance sheet as per significant accounting policy.

Balances of Govt. Grants:-

The unspent balance of grants will be ascertained and the excess of government grants over cost of fixed assets shall be shown as liability.

Educational General fund:-
The difference of assets and liabilities will be opening balance of educational fund. If liabilities exceed assets, opening balance will show negative figure.

Contingent Liabilities:-
The liabilities depended upon happening of an event are called contingent liabilities and is shown in opening balance sheet as notes to accounts. Some are as under:-

- In case of acquisition the amount paid extra due to litigation.
- Any compensation payable due to litigation etc.
- Any unforeseen liability occurring as a result of some past action which can not be ascertained.

Unexpired Capital Commitments:-
Amount of contracts awarded but yet to be executed or remaining amount of works under execution but not completed will form part of unexpired commitment and shown as a note to the opening balance sheet.

Retirement Benefits:-
Retirement benefits actually payable to the employees who have retired/left up to 1-04-2012 should be taken into the opening balance sheet.

Period End Procedures
The Educational Institutions should follow following period end procedures to facilitate preparation of financial statements:

a. Daily Procedures
- Closing of Cash Book
- Physical verification of cash balance
- Deposit of collections (both cash and cheque) in the bank.
- Checking ledger accounts with the books of original entries i.e. Cash Book and Journal Book
- Verification of number of receipts issued as reported by the collection office with the Collection Register
- Updation of Subsidiary Ledgers.

b. Monthly Procedures
- Bank Reconciliation
- Recording of expenditures incurred against permanent advances
- Payment of provident fund dues and pension contribution in respect of employees on deputation.
- Reconciliation of Functions wise Income/Expenditure. Subsidiary Ledgers with respective Trial Balance totals.
- Compilation of details of closing stock for recording the consumption of stores at the end of the months.
- Closing of ledger accounts.

c. Quarterly Procedures
- Reconciliation of deposits, advances, receivables and incomes

- Provision of period-end expenses
- Transfer of revenue grants received in advance for specific purpose to grant income.
- Recognition of grant income for revenue expenditure incurred in respect of grant receivable as reimbursement.
- Accrual of interest on borrowing.
- Recording of provisions for bills remaining unpaid in respect of Special Fund expenditure.
- Accrual for interest on investments
- Accrual of interest on loans to employees.
- Reconciliation of Capital Work in Progress.
- Reconciliation of Inter Unit Balances.
- Passing adjustment entries.
- Closing of ledger accounts.

d. Annual Procedures

- Physical verifications of stores
- Physical verification of fixed assets.
- Transfer of funds from special funds to Special Fund (Utilized).
- Confirmation of all categories of advances.
- Provisions of unrealised revenue.
- Accounting of prepaid expenses
- Contribution of difference in interest to the provident fund.
- Expenditure for the benefit of Backward classes or similar other welfare scheme.
- Confirmation from Government/Quasi-government and Government owned agencies.
- Closing of ledger accounts.

Reconciliation Procedures

Educational Institutions shall be carrying out certain reconciliation procedures to be carried out periodically in respect of their accounts. The objective of the reconciliation procedure is to ensure that if an accounting information is recorded at more than one place, there are no discrepancies between the different sets of records. . The reconciliation procedure will include the following:-

- Bank Reconciliation
- Inter Unit reconciliation
- Reconciliation of deposits.
- Reconciliation of receivable and collections in respect of taxes, cess, user charges and other revenues.
- Reconciliation of advances to contractors, suppliers, departments and employees.
- Reconciliation of borrowings.
- Reconciliation of payables including contractor's payable.
- Reconciliation of balances with government, Quasi-Government agencies Government Corporations and
- Reconciliation of loans given to others.
- Reconciliation of the accounts for the income and expense heads falling under the following categories with the Function wise Income/Expenditure Subsidiary Ledgers maintained at the Accounts Department in respect of those categories:
    - Fees and User Charges,

- Sale and Hire Charges
- Establishment Expenses
- Administrative Expenses, and
- Repair and Maintenance Charges.

Annual Financial Statements

The annual financial statements of the educational institutions shall include both annual accounts as well as reports. As per National Municipal Accounting Manual, the annual financial report of the educational institutions shall include the following

a. Financial Statements

- Balance Sheet
- Income and Expenditure Statement
- Statement of Cash Flows
- Receipts and Payments Account
- Notes to Accounts; and
- Financial Performance Indicators

b. Report of the Auditor;

Accounting Standards

ACCOUNTING STANDARDS (AS's) ARE WRITTEN POLICY DOCUMENTS ISSUED BY EXPERT ACCOUNTING BODY OR BY GOVERNMENT OR OTHER REGULATORY BODY COVERING THE ASPECTS OF RECOGNITION, MEASUREMENT, TREATMENT, PRESENTATION AND DISCLOSURE OF ACCOUNTING TRANSACTIONS IN THE FINANCIAL STATEMENTS.

1.1 Objectives of Accounting Standards

Accounting as a 'language of business' communicates the financial results of an enterprise to various stakeholders by means of financial statements. If the financial accounting process is not properly regulated, there is possibility of financial statements being misleading, tendentious and providing a distorted picture of the business, rather than the true state of affairs. In order to ensure transparency, consistency, comparability, adequacy and reliability of financial reporting, it is essential to standardize the accounting principles and policies. Accounting Standards provide framework and standard accounting policies so that the financial statements of different enterprises become comparable.

The Accounting Standards reduce the accounting alternatives in the preparation of rational financial statements thereby ensuring comparability of financial statements of different enterprises. The Accounting Standards deal with the issues of

i. recognition of events and transactions in the financial statements,

ii. measurement of these transactions and events,

iii. presentation of these transactions and events in the financial statements in a manner that is meaningful and understandable to the reader, and

iv. the disclosure requirements which should be there to enable the public at large and the stakeholders and the potential investors in particular, to get an insight into these financial statements which helps the users to take prudent and informed business decisions.

The objective of Accounting Standards is to standardize diverse accounting policies with a view to eliminate, to the maximum possible extent,

i. the non-comparability of financial statements and thereby improving the reliability of financial statements, and

ii. to provide a set of standard accounting policies, valuation norms and disclosure requirements.

The Institute of Chartered Accountants of India (ICAI), being a premier accounting body in the country, took upon itself the leadership role by constituting the Accounting Standards Board (ASB) in 1977. The ICAI has taken significant initiatives in the setting and issuing procedure of Accounting Standards to ensure that the standard-setting process is fully consultative and transparent. The ASB considers the International Accounting Standards (IASs)/International Financial Reporting Standards (IFRSs) while framing Indian Accounting Standards (ASs) and try to integrate them, in the light of the applicable laws, customs, usages and business environment in the country.

1.2 Benefits and Limitations

Accounting standards seek to describe the accounting principles, the valuation techniques and the methods of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view. By setting the accounting standards the accountant has following benefits:

i. Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.

ii. There are certain areas where important information are not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.

iii. The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards adopted in different countries.

However, there are some limitations of setting of accounting standards:

i. Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult.

ii. There may be a trend towards rigidity and away from flexibility in applying the accounting standards.

iii. Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

1.3 List of Accounting Standards

Following is the list of Accounting Standards with their respective date of applicability:

AS No.	AS Title	Date
1	Disclosure of Accounting Policies	01/04/1993
2	Valuation of Inventories (Revised)	01/04/1999
3	Cash Flow Statement (Revised)	01/04/2001
4	Contingencies and Events Occurring after the Balance Sheet Date	01/04/1998
5	Net Profit or Loss for the Period, Prior PeriodItems and Changes in Accounting Policies (Revised)	01/04/1996
6	Depreciation Accounting (Revised)	01/04/1995
7	Construction Contracts (Revised)	01/04/2002
8	Research & Development	Now included
9	Revenue Recognition	01/04/1993
10	Accounting for Fixed Assets	01/04/1993
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	01/04/1995
14	Accounting for Amalgamations	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	Earning Per Shares	01/04/2001

21	Consolidated Financial Statement	01/04/2001
22	Accounting for Taxes on Income	01/04/2001 01/04/2002 01/04/2006
23	Accounting for Investment in Associates in Consolidated Financial Statements	01/04/2002
24	Discontinuing Operations	01/04/2004
25	Interim Financial Statement	01/04/2002
26	Intangible Assets	01/04/2003
27	Financial Reporting of Interests in Joint Ventures	01/04/2002
28	Impairment of Assets	01/04/2004 01/04/2006 01/04/2008
29	Provisions, Contingent Liabilities and Contingent Assets	01/04/2004
30	Financial Instruments: Recognition and Measurement and Limited Revisions to AS 2, AS 11(revised 2003), AS 21, AS 23, AS 26, AS 27, AS 28 and AS 29.	01/04/2009 (Recommendatory) 01/04/2011 (Mandatory)
31	Financial Instruments: Presentation	01/04/2009 (Recommendatory) 01/04/2011 (Mandatory)
32	Financial Instruments: Disclosure and Limited Revision to AS 19	01/04/2009 (Recommendatory) 01/04/2011 (Mandatory)

AS 1: Disclosure of Accounting Policies

1. Introduction

Irrespective of extent of standardisation, diversity in accounting policies is unavoidable for two reasons. First, 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. Second, since enterprises operate in diverse situations, it is impossible to develop a single set of policies applicable to all enterprises for all time. The accounting standards therefore permit more than one policy even in areas covered by it. Differences in accounting policies lead to differences in reported information even if underlying transactions are same. The qualitative characteristic of comparability of financial statements therefore suffers due to diversity of accounting policies. Since uniformity is impossible, and accounting standards permit more than one alternative in many cases, it is not enough to say that all standards have been complied with. For these reasons, accounting standard 1 requires enterprises to disclose accounting policies actually adopted by them in preparation of their financial statements. Such disclosures allow the users of financial statements to take the differences in accounting policies into consideration and to make necessary adjustments in their analysis of such statements.

AS 1 deals with the disclosure of significant accounting policies followed in preparing and presenting financial statements. The purpose of the Standard is to promote better understanding of financial statements by establishing through an Accounting Standard the disclosure of significant accounting policies and the manner in which accounting policies are disclosed in the financial statements. Such disclosure would also facilitate a more meaningful comparison between financial statements of different enterprises.

2. Accounting Policies

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.
Accountant has to make decisions from various options for recording or disclosing items in the books of accounts e.g.:

Items to be disclosed	Method of disclosure or valuation
Inventories	FIFO, Weighted Average etc.
Cash Flow Statement	Direct Method, Indirect Method
Contingent Liabilities/Assets	Recorded, Provided for, Disclosed, Ignored…
Depreciation	Straight Line Method, Reducing Balance Method, Depletion Method etc.

This list is exhaustive i.e. endless. For every item right from valuation of assets and liabilities to recognition of revenue, providing for expected losses, for each event, accountant need to form a principles and evolve a method to adopt those principles. This method of forming and applying accounting principles is known as accounting policies.

As we say that accounts is both science and art. It's a science because we have some tested accounting principles, which are applicable universally, but simultaneously the application of these principles depends on the personal

ability of each accountant. Since different accountants may have different approach, we generally find that in different enterprise under same industry, different accounting policy is followed. Though ICAI along with Government is trying to reduce the number of accounting policies followed in India but still it cannot be reduced to one.

Since accounting policy adopted will have considerable effect on the financial results disclosed by the financial statement, it makes it almost difficult to compare two financial statements.

Financial statement in India includes the following:

Balance Sheet: It discloses the information regarding short term and long term solvency of the concern i.e. through balance sheet we can judge the financial status of an enterprise.

Profit & Loss Account: It reflects the net financial result of the functioning of an enterprise during the last financial year in terms of net profits or net losses.

Cash Flow Statement for Specified Enterprises: This not only gives the information for sources from where cash was acquired by the company to finance its activities during the relevant year but also helps in determining the future cash requirements of the concern.

Notes and Schedules forming the part of the above statements: This is an inevitable part of a financial statement, since it discloses the information that is not possible to be disclosed in Profit & Loss Account or Balance Sheet and also it clarifies the points, absence of which might misguide the user of accounts.

During 1979, when ASB was established, the business environment in India was such that enterprises were reluctant to prepare accounting notes, few enterprises used to disclose the important accounting policies but the degree and method of disclosure varies considerably. Some enterprises used to disclose them as part of main financial statement, few others as a supplementary.

Therefore the main aim of this statement is not only to promote disclosure of accounting policies but also to determine that all accounting policies are disclosed at one place as main part of the financial statement. The main purpose of Accounting Standard 1, Disclosure of Accounting Policies, is to promote better understanding of financial statements by requiring disclosure of significant accounting policies in orderly manner. As explained in the preceding paragraph, such disclosures facilitate more meaningful comparison between financial statements of different enterprises for same accounting periods. The standard also requires disclosure of changes in accounting policies such that the users can compare financial statements of same enterprise for different accounting periods.

3. Fundamental Accounting Assumptions

The Accounting Standard 1 recognises three fundamental accounting assumptions. These are

a. Going Concern
b. Consistency and
c. Accrual.

So long as these assumptions are followed in preparation of financial statements, no disclosure of such adherence is

necessary. Any departure from any of these assumptions should however be disclosed.

a. **Going Concern Assumption:** The enterprise is normally viewed as a going concern, i.e. as continuing operations for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or curtailing, materially its scale of operations.

   Accordingly, assets and liabilities are recorded on the basis that the enterprise will be able to realise its assets and discharge its liabilities in the normal course of business. If an enterprise is not a going concern, valuation of its assets and liabilities on historical cost becomes irrelevant and as a consequence its profit/loss may not give reliable information.

   For example: A Ltd. been acquired by B Ltd. during May 2006, since now B Ltd. is no more a going concern, this fact should be disclosed in the financial statement of B Ltd. for the year ended March 31, 2006.

b. **Accrual Assumption:** Revenues and costs are recorded as they accrued, i.e., revenue items recognized as they are earned or incurred and recorded in the financial statements of the periods to which they relate even though payment and receipt of actual cash has not taken place. This assumption is the core of accrual accounting system.

   For example: Credit sales of goods on March 01, 2010; money receivable after three months, are recognised as sales during the financial year 2009-10 itself and amount due is debited to the customer's account. Similarly credit purchase of goods is also recorded as purchases during the year when purchase takes place and amount payable is credited to the suppliers account.

c. **Consistency Assumption:** It is assumed that accounting policies are consistent from one period to another. Unless this is done, comparatives are rendered meaningless. If comparability is lost, the relevance of accounting data for users' judgment and decision-making is gone.

   For example: If enterprise has opted for written down value method of charging depreciation then in the following years, it should stick to this method, unless under changed environment it is considered highly inappropriate to continue with it.

4. Considerations in the Selection of Accounting Policies

The primary consideration in the selection of accounting policies by an enterprise is that the financial statements prepared and presented on the basis of such accounting policies should represent a true and fair view of the state of affairs of the enterprise as at the balance sheet date and of the profit or loss for the period ended on that date. To ensure the true and fair consideration this statement issues following guidelines:

Prudence: As defined in the statement, prudence means recognising all losses immediately but ignoring anticipated profits. Business environment is highly dynamic, therefore, enterprises has to keep anticipate the future and take managerial decisions accordingly. In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash. Provision is made 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. For Example: If valuation of stock is always done at cost, consider a situation where market price of the relevant goods has reduced below the cost price, then valuing stock at cost price means ignoring anticipated losses. Similarly if stock is always valued at market price, then take a situation where cost price is below market price, indirectly we are recognising the anticipated gross profit on stock in the books. Therefore, accounting policy should be cost price or market price whichever is less, in this case we are ignoring anticipated profits (if any) but any anticipated losses would be taken care of.

Substance over form: The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form.

For Example: The ownership of an asset purchased on hire purchase is not transferred till the payment of the last instalment is made but the asset is shown in the books of the hire purchaser. Similarly, in the case of the amalgamation, the entry for amalgamation in the books of the amalgamated company is recorded on the basis of the status of the shareholders of amalgamating company after amalgamation i.e. if all or almost all the shareholders of the amalgamated company has become shareholder of the amalgamating company by virtue of amalgamation, we record all the transactions as Amalgamation in nature of Merger otherwise it is recorded as Amalgamation in nature of Purchase.

Materiality: Financial statements should disclose all 'material' items, i.e. items the knowledge of which might influence the decisions of the user of the financial statements.

The materiality of an item is decided on the basis that whether non-disclosure of the item will effect the decision making of the user of accounts. If the answer is positive then the item is material and should be disclosed, in case answer is negative, item is immaterial. By this statement does not mean that immaterial item should not be disclosed, disclosure or non-disclosure of an immaterial item is left at the discretion of the accountant but disclosure of material item is been made mandatory.

For Example, Any penalty paid by the enterprise should be disclosed separately even though the amount paid is negligible, payment of any tax also should be disclosed separately and not to be merged with office expenses or miscellaneous expense.

5. Disclosure of Accounting Policies

i. To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

ii. 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.

6. Disclosure of Changes in Accounting Policies

Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in a later period should be disclosed. In the case of a change in accounting policies, which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable,

wholly or in part, the fact should be indicated.

7. Disclosure of Deviations from Fundamental Accounting Assumptions

If the fundamental accounting assumptions, viz. Going concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

The principle of consistency refers to the practice of using same accounting policies for similar transactions in all accounting periods. The deviation from the principle of consistency therefore means a change in accounting policy, the disclosure requirements for which are covered by paragraph 26 of the standard.

8. Illustrations

Illustration 1

A Ltd. has sold its building for Rs. 50 lakhs to B Ltd. and has also given the possession to B Ltd. The book value of the building is Rs. 30 lakhs. As on 31st March, 2012, the documentation and legal formalities are pending. The company has not recorded the sale and has shown the amount received as advance. Do you agree with this treatment?

Solution

The economic reality and substance of the transaction is that the rights and beneficial interest in the property has been transferred although legal title has not been transferred. A Ltd. should record the sale and recognize the profit of Rs. 20 lakhs in its profit and loss account. The building should be eliminated from the balance sheet.

Illustration 2

ABC Ltd. was making provision for non-moving stocks based on no issues for the last 12 months up to 31.3.2011. The company wants to provide during the year ending 31.3.2012 based on technical evaluation:

Total value of stock	Rs. 100 lakhs
Provision required based on 12 months issue	Rs. 3.5 lakhs
Provision required based on technical evaluation	Rs. 2.5 lakhs

Does this amount to change in Accounting Policy? Can the company change the method of provision?

Solution

The decision of making provision for non-moving stocks on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving stocks should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of stock, the change in the amount of required provision of non-moving stock from Rs. 3.5 lakhs to Rs. 2.5 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2011-12:

"The company has provided for non-moving stocks on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been higher by Rs. 1 lakh."

AS 2: Valuation of Inventories

1. Introduction

The accounting treatment for inventories is prescribed in AS 2 'Valuation of Inventories', which provides guidance for determining the value at which inventories, are carried in the financial statements until related revenues are recognised. It also provides guidance on the cost formulas that are used to assign costs to inventories and any write-down thereof to net realisable value.

This Statement does not apply in accounting for the following inventories:

a. Work in progress arising under construction contracts, including directly related service contracts.
b. Work in progress arising in the ordinary course of business of service providers.

c. Shares, debentures and other financial instruments held as stock-in-trade and

d. Producers' inventories of livestock, agricultural and forest products, and mineral oils, ores and gases to the extent that they are measured at net realisable value in accordance with well established practices in those industries.

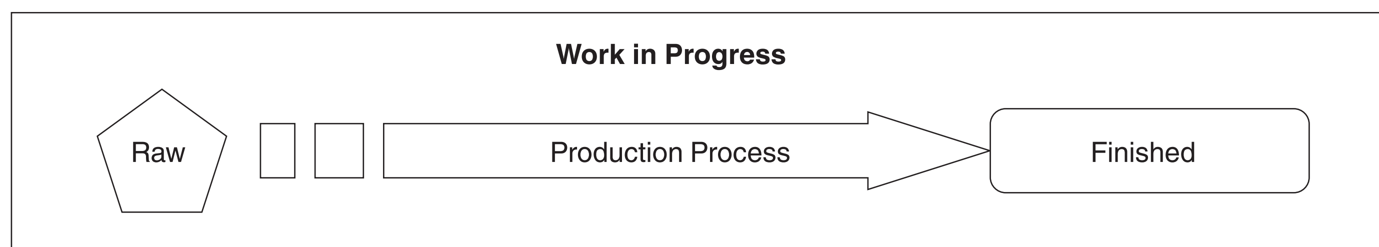
2. Scope

AS 2 defines inventories as assets

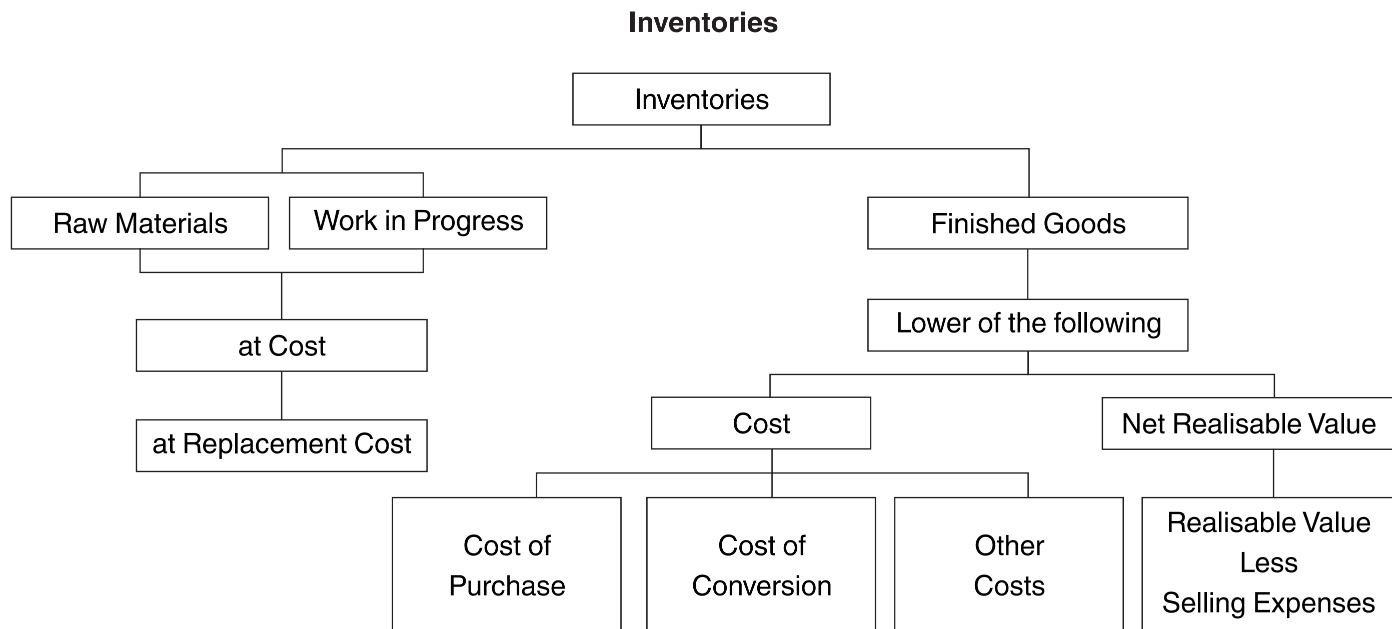
a. Held for sale in the ordinary course of business. It means finished goods ready for sale in case of a manufacturer and for traders, goods purchased by them with the intention of resale but not yet sold. These are known as Finished Goods.

b. In the process of production for such sale. These refer to the goods which are introduced to the production process but the production is not yet completed i.e. not fully converted into finished goods. These are known as Work-in-Progress.

c. In the form of materials or supplies to be consumed in the production process or in the rendering of services. It refers to all the materials and spares i.e. to be consumed in the process of production. These are known as Raw Materials.



Inventories



3. Measurement of Inventories

Inventories should be valued at the lower of cost and net realisable value.

Cost of goods is the summation of:

a. Cost of Purchase.

b. Cost of Conversion.

c. Other cost necessary to bring the inventory in present location and condition.

As shown in the above diagram, finished goods should be valued at cost or market price whichever is lower, in other words, finished goods are valued at the lower of cost or net realisable value.

Cost has three elements as discussed below:

Cost of Purchase: Cost of purchase includes the purchase price plus all other necessary expenses directly attributable to purchase of stock like, taxes, duties, carriage inward, loading/unloading excluding expenses recoverable from the supplier.

From the above sum, following items are deducted, duty drawback, CENVAT, VAT, trade discount, rebates.

Cost of Conversion: For a trading company cost of purchase along with other cost (discussed below) constitutes cost of inventory, but for a manufacturer cost of inventory also includes cost of conversion. Readers can recollect the calculation of factory cost calculated in Cost Accounting:

Direct Material + Direct Labour = Prime Cost

Prime Cost + Factory Variable Overhead + Factory Fixed Overhead = Factory Cost.

Direct material is included in cost of purchase and the remaining items i.e. direct labour and overheads are termed as cost of conversion.

Direct labour is cost of workers in the unit who are directly associated with the production process, in other words we can say that direct labour is the cost of labour which can be directly attributed to the units of production.

Overheads are indirect expenses. Variable overheads are indirect expenses which is directly related to production i.e., it changes with the change in production in the same proportion (increase or decrease). Fixed overheads generally remains constant, it varies only when there is some major shift in production.

Since direct labour and variable overheads are directly with the production level, it is advisable to include them in cost of conversion on the basis of normal capacity. Because any difference between normal capacity and actual production will also bring in proportionate change in projected cost and actual cost.

For example: A unit is expected to produce 1 lacs units in a year with the projected labour cost Rs. 20 lacs and variable overhead Rs. 10 lacs. But the actual cost was only Rs. 18 lacs labour charges and Rs. 9 lacs overheads with production only 90,000 units. Now if we take these costs on normal capacity basis then direct labour is Rs. 20 per unit (20 lacs/1 lac) and variable overhead is Rs. 10 per unit (10 lacs/1 lac). Therefore in cost of conversion we include direct labour (90,000 x 20) Rs. 18 lacs and variable overheads (90,000 x 10) Rs. 9 lacs.

Fixed overheads are taken on the basis of normal capacity when actual production is equal to normal capacity or the difference is minor. In case when actual production increases normal capacity considerably, fixed overheads are included on the basis of actual capacity. When actual production is substantially less than normal capacity, fixed overhead is included on the basis of normal capacity. To understand the reason for such a provision we take an example:

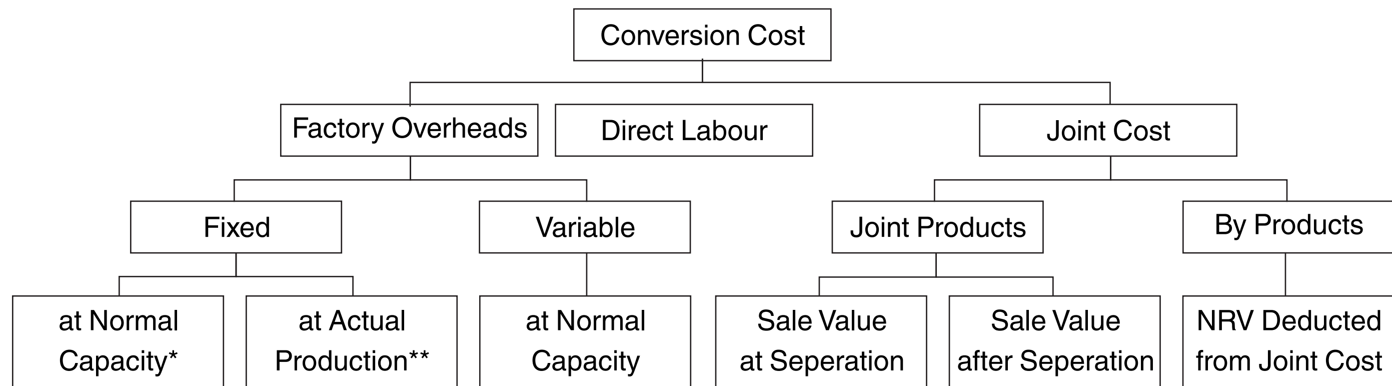
ABC Ltd. has a plant with the capacity to produce 1 lac unit of a product per annum and the expected fixed overhead is Rs. 18 lacs. Fixed overhead on the basis of normal capacity is Rs. 18 (18 lacs/1 lac).

Case 1: Actual production is 1 lac units. Fixed overhead on the basis of normal capacity and actual overhead will lead to same figure of Rs. 18 lacs. Therefore it is advisable to include this on normal capacity.

Case 2: Actual production is 90,000 units. Fixed overhead is not going to change with the change in output and will remain constant at Rs. 18 lacs, therefore, overheads on actual basis is Rs. 20 (18 lacs/ 90 thousands). Hence by valuing stock at Rs. 20 each for fixed overhead purpose, it will be overvalued and the losses of Rs. 1.8 lacs will also be included in closing stock leading to a higher gross profit then actually earned. Therefore, it is advisable to include fixed overhead on normal capacity (90,000 x 18) Rs. 16.2 lacs and rest Rs. 1.2 lacs will be transferred to Profit & Loss Account.

Case 3: Actual production is 1.2 lacs units. Fixed overhead is not going to change with the change in output and will remain constant at Rs. 18 lacs, therefore, overheads on actual basis is Rs. 15 (18 lacs/ 1.2 lacs). Hence by valuing stock at Rs. 18 each for fixed overhead purpose, we will be adding the element of cost to inventory which actually has not been incurred. At Rs. 18 total overhead will come to Rs. 21.6 lacs whereas actual overhead expense is only Rs. 18 lacs. Therefore, it is advisable to include fixed overhead on actual basis (1.2 lacs x 15) Rs. 18 lacs.

Sometimes, a single production process may result in more than one product. In case, this additional product is the intended and has a good market value, they are known as joint products. The cost of conversion incurred on all the production and not identifiable separately is allocated among the products on some rational and consistent basis. If this additional product don't have good market value then they are considered as by-products. In this case the net realisable value of the by-products are deducted from the total cost of conversion to calculate the cost of conversion for main product.



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

Other Costs: Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include overheads other than production overheads or the costs of designing products for specific customers in the cost of inventories.

AS 2 gives the following as examples of costs that should be excluded from the cost of inventories and recognised as expenses in the period in which they are incurred:

a. Abnormal amounts of wasted materials, labour, or other production costs.

b. Storage costs, unless those costs are necessary in the production process prior to a further production stage.

c. Administrative overheads that do not contribute to bringing the inventories to their present location and condition and

d. Selling and distribution costs.

Illustration 1

A ltd. purchased 1,00,000 MT for Rs. 100 each MT of raw material and introduced in the production process to get 85,000 MT as output. Normal wastage is 5%. In the process, company incurred the following expenses:

Direct Labour	Rs. 10,00,000
Direct Variable Overheads	Rs. 1,00,000
Direct Fixed Overheads	Rs. 1,00,000
(Including interest Rs. 40,625)	

Of the above 80,000 MT was sold during the year and remaining 5,000 MT remained in closing stock. Due to fall in demand in market the selling price for the finished goods on the closing day was estimated to be Rs. 105 per MT. Calculate the value of closing stock.

Solution:

Calculation of cost for closing stock

Particulars	**Rs.**
Cost of Purchase (1,00,000 x 100)	1,00,00,000
Direct Labour	10,00,000
Variable Overhead	1,00,000
Fixed Overhead $\frac{(1,00,000 - 40,625) \times 85,000}{95,000}$	53,125
Cost of Production	1,11,53,125
Cost of closing stock per unit (1,11,53,125/85,000)	Rs. 131 (approx)
Net Realisable Value per unit	Rs. 105

Since net realisable value is less than cost, closing stock will be valued at Rs. 105. Therefore closing stock is Rs. 5,25,000 (5,000 x 105).

Borrowing Costs

Interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are, therefore, usually not included in the cost of inventories.

There may, however, be few exceptions to the above rule. As per AS 16, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of the qualifying asset. Accordingly, inventories that necessarily take a substantial period of time to bring them to a saleable condition are qualifying assets.

As per AS 16, for inventories that are qualifying assets, any directly attributable borrowing costs should be capitalised as part of their cost.

4. Cost Formulas

Following are the various cost formulae suggested by the statement:

Specific Identification Method: It is suitable for the inventories where each unit of stock along with their associated

cost can be separately identified. In other words, it is suitable where one unit of stock is not interchangeable with another unit. Under this method each unit is valued specifically on its original cost. Examples for such goods are ship building, machinery building…

The specific identification method is not appropriate for the routine production of inventories that are ordinarily interchangeable, since, in such circumstances, an enterprise could obtain predetermined effects on the net profit or loss for the period by selecting a particular method of ascertaining the items that remain in inventories.

For items where are interchangeable, most appropriate method of cost valuation is either of the following two:

FIFO (First In First Out): It is assumed under this method that whatever is received first is issued first, which means, the stock left over belongs to the latest purchases. Closing stock is valued at the rates for the equivalent units purchased at last. During inflation stock is valued at higher price and during decrease in price, stock is valued at lower price.

Weighted Average Price: Under this method of stock valuation, to determine the cost per unit, total cost of production during the year is divided by total units. In other words, for price per unit of the closing stock we take the average price of the total goods purchased or produced during the year.

Following are cost formulae or techniques of measurement of cost suggested by AS for some special cases:

Standard Cost Method: Inventories are valued on the basis of the set standards, which are realistic and reviewed regularly and where necessary, revised in the light of the current conditions. Standard costs take into account normal levels of consumption of materials and supplies, labour, efficiency and capacity utilisation.

Adjusted Selling Price Method or Retail Method: It is recommended for retail business or in the business where the inventory comprises of many items, the individual costs of which are not readily ascertainable. All the inventories are valued at the selling price, which is then adjusted with normal gross profit ratio and selling expenses to reach at its cost.

Illustration 2

Ambica Stores is a departmental store, which sell goods on retail basis. It makes a gross profit of 20% on net sales. The following figures for the year-end are available:

Opening Stock Rs. 50,000;Purchases Rs. 3,60,000; Purchase Returns Rs. 10,000; Freight Inwards Rs. 10,000;Gross Sales Rs. 4,50,000; Sales Returns Rs. 11,250; Carriage Outwards Rs. 5,000.

Compute the estimated cost of the inventory on the closing date.

Solution:

Calculation of cost for closing stock

Particulars	Rs.
Opening Stock	50,000
Purchases less returns (Rs. 3,60,000 - Rs. 10,000)	3,50,000
Freight Inwards	10,000
	4,10,000
Less: Net Sales (Rs. 4,50,000 - Rs. 11,250)	(4,38,750)
	(28,750)
Add: Gross Profits (Rs. 4,38,750 x 20%)	87,750
Closing Stock	59,000

5. Net Realisable Value (NRV)

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

When we say that stock should be valued at the lower of cost or net realisable value, one should note that only under two circumstances cost of inventories will surpass its net realisable value:

1. The goods are damaged or obsolete and not expected to realise the normal sale price.
2. The cost necessary for the production of goods has gone up by greater degree.

Both the above cases we don't expect in the normal functioning of the business, hence whenever it is found that goods are valued at NRV, care should be taken to study the existing market position for the relevant products.

NRV of the goods are estimated on item to item basis and only items of the same characteristics are grouped together. Such estimation is made at the time of finalisation of accounts and circumstances existing on the date of balance sheet evident from the events after the balance sheet confirming the estimation should be taken into consideration. And assessment is made on each balance sheet date of such estimation.

While estimating the NRV, the purpose of holding the stock should also be taken into consideration. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess inventory is based on general selling prices. Contingent losses on firm sales contracts in excess of inventory quantities held and contingent losses on firm purchase contracts are dealt with in accordance with the principles enunciated in AS 4, Contingencies and Events Occurring After the Balance Sheet Date.

For example, concern has 10,000 units in stock, of which 6,000 is to be delivered for Rs. 40 each as per a contract with one of the customer. Cost of stock is Rs. 45 and NRV estimated to be Rs. 50. In this case 6,000 units will be valued @ Rs. 40 each and rest 4,000 units will be valued @ Rs. 45 each.

This provision of cost or NRV whichever is less, is applicable only those goods which are ready for sale i.e. finished goods. Since raw materials and work in progress are not available for sale, they don't have any realisable value and therefore NRV can never be estimated. For these goods statement suggests that these should always be valued at cost. Only exception is the case when the net realisable value of the relevant finished goods is higher than cost, in this case, the relevant raw materials and work in progress should be valued at replacement cost.

Illustration 3

Particulars		Kg.	Rs.
Opening Stock:	Finished Goods	1,000	25,000
	Raw Materials	1,100	11,000
Purchases		10,000	1,00,000
Labour			76,500
Overheads (Fixed)			75,000
Sales		10,000	2,80,000
Closing Stock:	Raw Materials	900	
	Finished Goods	1200	

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was Rs. 20 per kg and the replacement cost for the raw material was Rs. 9.50 per kg on the closing day. You are required to calculate the closing stock as on that date.

Solution

Calculation of cost for closing stock

Particulars	Rs.
Cost of Purchase (10,200 x 10)	1,02,000
Direct Labour	76,500
Fixed Overhead $\frac{75,000 \times 10,200}{15,000}$	51,000
Cost of Production	2,29,500
Cost of closing stock per unit (2,29,500/10,200)	Rs. 22.50
Net Realisable Value per unit	Rs. 20.00

Since net realisable value is less than cost, closing stock will be valued at Rs. 20.

As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i.e. Rs. 9.50.

Therefore, value of closing stock: Finished Goods (1,200 x 20)	Rs. 24,000
Raw Materials (900 x 9.50)	Rs. 8,550
	Rs. 32,550

6. Disclosure

The financial statements should disclose:

a. The accounting policies adopted in measuring inventories, including the cost formula used; and

b. The total carrying amount of inventories together with a classification appropriate to the enterprise.

Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are

1. raw materials and components,
2. work in progress,
3. finished goods, stores and spares,
4. and loose tools.

AS 3: Cash Flow Statement (CFS)

1. Objective

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 utilised (outflow of cash) by the enterprise. This helps the users of accounts:

- To identify the historical changes in the flow of cash & cash equivalents.
- To determine the future requirement of cash & cash equivalents.
- To assess the ability to generate cash & cash equivalents.
- To estimate the further requirement of generating cash & cash equivalents.
- To compare the operational efficiency of different enterprises.
- To study the insolvency and liquidity position of an enterprise.

Cash comprises cash on hand and demand deposits with banks.
Cash equivalents are:

- Short term (maximum three months of maturity from the date of acquisition),

- Highly liquid investments,
- Readily convertible,
- Convertible amounts of cash is known,
- Subject to an insignificant risk of changes in value.

For example, Share Capital is not considered as cash equivalent even though they are readily convertible into cash because, the amount that will be realized on sale of investment is not determinable unless investment is actually sold. Similarly, fixed deposit for one year is also not considered as cash equivalent because they are not readily convertible into cash, even though the amount is determinable.

One should not be confused with the concept of three months or less. As this standard state very clearly that three months or less from the date of acquisition, any investment which is not classified as cash equivalent cannot be reclassified as cash equivalent, even when the maturity period is less than three months. We should look at the status only on the date of acquisition and not later.

Cash flows are inflows and outflows of cash and cash equivalents.

2. Presentation of a Cash Flow Statement

AS 3 'Cash Flow Statements' requires the presentation of information about the historical changes in the cash and cash equivalents of an enterprise in the relevant accounting year by means of a cash flow statement, which classifies cash flows during the period according to operating, investing and financing activities.

Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

Examples of cash flows from operating activities are:

- cash received in the year from customers (in respect of sale of goods or services rendered either in the year, or in an earlier year, or received in advance in respect or the sale of goods or services to be rendered in a later year);

- cash payments in the year to suppliers (for raw materials or goods for resale whether supplied in the current year, or an earlier year, or to be supplied in a later year);

- the payment of wages and salaries to employees;

- tax and other payments on behalf of employees;

- the payment of rent on property used in the business operations; royalties received in the year;

- cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits;

- the payment of insurance premiums;

- cash payments or refunds of income taxes that cannot be specifically identified with financing or investing activities

- cash flows arising from futures contracts, forward contracts, option contracts or swap contracts hedging a transaction that is itself classified as operating; and

- cash flows arising from the purchase and sale of securities and loans held for dealing or trading purposes.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Examples of cash flows arising from investing activities include:

- cash payment to acquire fixed assets (including intangibles). These payments include those relating to capitalised research and development costs and self-constructed fixed assets;

- cash receipts from disposal of fixed assets (including intangibles);

- cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

- cash receipts from disposal of shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

- cash advances and loans made to third parties (other than advances and loans made by a financial enterprise);

- cash receipts from the repayment of advances and loans made to third parties (other than advances and loans of a financial enterprise);

- cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and

- cash receipts from futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading purposes or the receipts are classified as financing activities.

Financing activities are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.

Examples of cash flows arising from financing activities are:

- cash proceeds from issuing shares or other similar instruments;
- cash proceeds from issuing debentures, loans, notes, bonds, and other short or long-term borrowings; and
- cash repayments of amounts borrowed.

So all the transactions should be classified under each of these heads and presented in CFS, this kind of presentation gives a very clear idea to the users regarding the major sources of cash inflows, from where all the activities are financed by the enterprises. Say if net cash flow from operating activities is negative and net cash flow from investing activities is positive, this does not portrait a good picture of the functioning of the enterprise. Sometimes, a single transaction may include cash flows that are classified differently. For example, when the instalment paid in respect of a fixed asset acquired on deferred payment basis includes both interest and loan, the interest element is classified under financing activities and the loan element is classified under investing activities.

Illustration 1

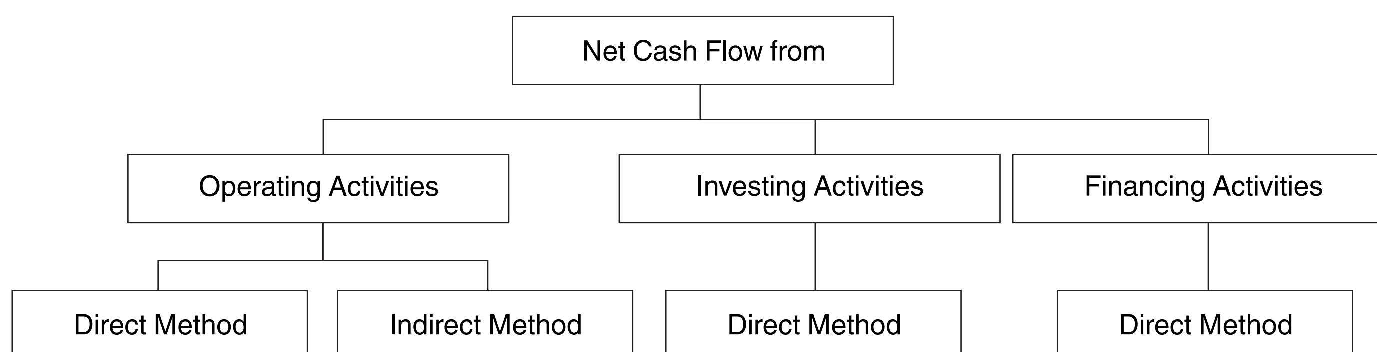
Classify the following activities as (a) Operating Activities, (b) Investing Activities, (c) Financing Activities (d) Cash Equivalents.

a. Purchase of Machinery.
b. Proceeds from issuance of equity share capital
c. Cash Sales.
d. Proceeds from long-term borrowings.
e. Proceeds from Debtors.
f. Cash receipts from Debtors.
g. Trading Commission received.
h. Purchase of investment.
i. Redemption of Preference Shares.
j. Cash Purchases.
k. Proceeds from sale of investment
l. Purchase of goodwill.
m. Cash paid to suppliers.
n. Interim Dividend paid on equity shares.
o. Wages and salaries paid.
p. Proceed from sale of patents.
q. Interest received on debentures held as investment.
r. Interest paid on Long-term borrowings.
s. Office and Administration Expenses paid
t. Manufacturing Overheads paid.
u. Dividend received on shares held as investments.
v. Rent Received on property held as investment.
w. Selling and distribution expense paid.
x. Income tax paid
y. Dividend paid on Preference shares.
z. Underwritings Commission paid.
  aa. Rent paid.
  bb. Brokerage paid on purchase of investments.
  cc. Bank Overdraft
  dd. Cash Credit
  ee. Short-term Deposits
  ff. Marketable Securities

gg. Refund of Income Tax received.

Solution
Operating Activities: c, e, f, g, j, m, o, s, t, w, x, aa & gg.
Investing Activities: a, h, k, l, p, q, u, v, bb & ee.
Financing Activities: b, d, i, n, r, y, z, cc & dd.
Cash Equivalent: ff.

Cash Flow during the year is



Operating Activities
As discussed earlier, operating activities are those activities which determine the profit/loss result of the enterprise, hence this head helps us to determine that whether the concern has sufficient cash inflow from their normal operations to support their operating cash outflow, and also the other cash outflow.

There are few items extraordinary items, which are recorded in Profit and Loss Account, but are not to be classified as operating activity, such as, profit/loss on sale of fixed asset. Fixed assets are to be classified as investing activities, therefore any sale proceeds from such items will go to investing activities. If investments are held as stock in trade, in such a case we will disclose them as operating activities.

Net cash flow from operating activities can be reported either as direct method or as indirect method.

In 'Direct method' we take the gross receipts from sales, debtors and other operating inflows subtracted by gross payments for purchases, creditors and other expenses ignoring all non-cash items like depreciation, provisions. In 'Indirect method' we start from the net profit or loss figure, eliminate the effect of any non cash items, investing items and financing items from such profit figure i.e. all such expenses like depreciation, provisions, interest paid, loss on sale of assets etc. are added and interest received etc. are deducted. Adjustment for changes in working capital items are also made ignoring cash and cash equivalent to reach to the figure of net cash flow.

Direct method is preferred over indirect because, direct method gives us the clear picture of various sources of cash inflows and outflows which helps in estimating the future cash inflows and outflows.

Below is the format for Cash Flow Statement

Cash Flow Statement of X Ltd. for the year ended March 31, 20xx (Direct Method)

Particulars	Rs.	Rs.
Operating Activities:		
Cash received from sale of goods	xxx	
Cash received from Debtors	xxx	
Cash received from sale of services	xxx	xxx
Less: Payment for Cash Purchases	xxx	
Payment to Creditors	xxx	
Payment for Operating Expenses	xxx	
e.g. power, rent, electricity…		
Payment for wages & Salaries	xxx	
Payment for Income Tax	xxx	xxx
		xxx
Adjustment for Extraordinary Items		xxx
Net Cash Flow from Operating Activities		xxx

Cash Flow Statement of X Ltd. for the year ended March 31, 20xx (Direct Method)

Particulars	Rs.	Rs.
Operating Activities:		
Closing balance of Profit & Loss Account	xxx	
Less: Opening balance of Profit & Loss Account	xxx	
	xxx	
Reversal the effects of Profit & Loss Appropriation Account	xxx	
Add: Provision for Income Tax	xxx	
Effects of Extraordinary Items	xxx	
Net Profit Before Tax and Extraordinary Items	xxx	
Reversal the effects of non-cash and non-operating items	xxx	
Effects for changes in Working Capital except cash & cash equivalent	xxx	
	xxx	
Les : Payment of Income Tax	xxx	xxx
Adjustment for Extraordinary Items		xxx
Net Cash Flow from Operating Activities		xxx

Illustration 2

From the following information, calculate cash flow from operating activities:

Summary of Cash Account
for the year ended March 31, 2012

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1,00,000	By Cash Purchases	1,20,000
To Cash sales	1,40,000	By Creditors	1,57,000
To Debtors	1,75,000	By Office & Selling Expenses	75,000
To Trade Commission	50,000	By Income Tax	30,000
To Sale of Investment	30,000	By Investment	25,000
To Loan from Bank	1,00,000	By Repay of Loan	75,000
To Interest & Dividend	1,000	By Interest on loan	10,000
		By Balance c/d.	1,04,000
	5,96,000		5,96,000

Cash Flow Statement of X Ltd. for the year ended March 31, 20xx (Direct Method)

Particulars	Rs.	Rs.
Operating Activities:		
Cash received from sale of goods	1,40,000	
Cash received from Debtors	1,75,000	
Trade Commission received	50,000	3,65,000
Less: Payment for Cash Purchases	1,20,000	
Payment to Creditors	1,57,000	
Office and Selling Expenses	75,000	
Payment for Income Tax	30,000	(3,82,000)
Net Cash Flow from Operating Activities		(17,000)

Illustration 3

Ms. Jyoti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year 2011 :

	Rs. in Lakhs
Net Profit	25,000
Dividend (including dividend tax) paid	8,535
Provision for Income tax	5,000
Income tax paid during the year	4,248
Loss on sale of assets (net)	40
Book value of the assets sold	185
Depreciation charged to Profit & Loss Account	20,000
Amortisation of Capital grant	6
Profit on sale of Investments	100
Carrying amount of Investment sold	27,765
Interest income on investments	2,506
Increase expenses	10,000
Interest paid during the year	10,520
Increase in Working Capital (excluding Cash & Bank Balance)	56,075
Purchase of fixed assets	14,560
Investment in joint venture	3,850
Expenditure on construction work in progress	34,740
Proceeds from calls in arrear	2
Receipt of grant for capital projects	12
Proceeds from long-term borrowings	25,980
Proceeds from short-term borrowings	20,575
Opening cash and Bank balance	5,003
Closing cash and Bank balance	6,988
Required :	

Prepare the Cash Flow Statement for the year 2011 in accordance with AS 3, Cash Flow Statements issued by the Institute of Chartered Accountants of India.

Solution

Star Oils Limited
Cash Flow Statement
for the year ended 31st December, 2011

	Rs. in Lakhs
Cash flows from operating activities	
Net profit before taxation (25,000 + 5,000)	30,000
Adjustments for :	
Depreciation	20,000
Loss on sale of assets (Net)	40
Amortisation of capital grant	(6)
Profit on sale of investments	(100)
Interest income on investments	(2,506)
Interest expenses	10,000
Operating profit before working capital changes	57,428
Changes in working capital (Excluding cash and bank balance)	(56,075)
Cash generated from operations	1,353
Income taxes paid	(4,248)
Net cash used in operating activities	(2,895)
Cash flows from investing activities	
Sale of assets	145
Sale of investments (27,765 + 100)	27,865
Interest income on investments	2,506
Purchase of fixed assets	(14,560)
Investment in joint venture	(3,850)
Expenditure on construction work-in progress	(34,740)
Net cash used in investing activities	(22,634)
Cash flows from financing activities	
Proceeds from calls in arrear	2
Receipts of grant for capital projects	12
Proceeds from long-term borrowings	25,980
Proceed from short-term borrowings	20,575
Interest paid	(10,520)
Dividend (including dividend tax) paid	(8,535)

	27,514
Net increase in cash and cash equivalents	1,985
Cash and cash equivalents at the beginning of the period	5,003
Cash and cash equivalents at the end of the period	6,988

Working Note :

	Rs. in Lakhs
Book value of the assets sold	185
Less : Loss on sale of assets	(40)
Proceeds on sale	145

Assumption :
Interest income on investments Rs. 2,506 has been received during the year.

AS 4: Contingencies and Events Occurring after the Balance Sheet Date

1. Contingencies

Contingency is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events. (Refer to unit 29 for discussion on AS 29)

2. 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, and, by the corresponding approving authority in the case of any other entity.

For example, for the year ending on 31st March 2010, financial statement is finalized and approved by the company in its AGM held on 04th September 2010. In this case the events taking place between 01st April 2010 to 04th September 2010 are termed as events occurring after the balance sheet date.

Two types of events can be identified

a. those which provide further evidence of conditions that existed at the balance sheet date. For example a debtor declared insolvent and estate unable to pay full amount against whom provision for doubtful debt was created.

b. those which are indicative of conditions that arose subsequent to the balance sheet date. An event which ceases the enterprise from being going concern.

Adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. For example, an adjustment may be made for a loss on a trade receivable account which is

confirmed by the insolvency of a customer which occurs after the balance sheet date.

Adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. An example is the decline in market value of investments between the balance sheet date and the date on which the financial statements are approved. Events occurring after the balance sheet date which do not affect the figures stated in the financial statements would not normally require disclosure in the financial statements although they may be of such significance that they may require a disclosure in the report of the approving authority to enable users of financial statements to make proper evaluations and decisions.

There are events which, although take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. Such items include the amount of dividend proposed or declared by the enterprise after the balance sheet date in respect of the period covered by the financial statements.

Assets and liabilities should be adjusted for events occurring after the balance sheet date that indicate that the fundamental accounting assumption of going concern (i.e. existence or substratum of the enterprise) is not appropriate.

3. Disclosure

Disclosure of events occurring after the balance sheet date require the following information should be provided:

a. The nature of the event;
b. An estimate of the financial effect, or a statement that such an estimate cannot be made.

4. Illustrations

Illustration 1

Pure Oil Ltd. closed the books of accounts on March 31, 2012 for which financial statement was finalized by the Board of Directors on September 04, 2012. During the month of December 2011, company under took the project of laying a pipeline across the country and during May 2012 engineers realized that due to unexpected heavy rain, the total cost of the project will be inflated by Rs. 50 lakhs. How this should be provided for in the balance sheet of 2011-12 accordance to AS 4?

Solution

This event occurred after March 31, 2012 but before September 04, 2012 is an event occurring after the balance sheet date. But this event is not affecting financial position on the date of balance sheet therefore it should be disclosed in the financial statement by the directors.

Illustration 2

In preparing the financial statements of R Ltd. for the year ended 31st March, 2012, you come across the following information. State with reasons, how you would deal with this in the financial statements:

The company invested 100 lakhs in April, 2012 in the acquisition of another company doing similar business, the negotiations for which had started during the year.

Solution

Para 3.2 of AS 4 (Revised) defines "Events Occurring after the Balance Sheet Date" as 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. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2012. Applying para 15 which clearly states that/disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of Rs. 100 lakhs in April, 2012 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

Illustration 3

A Limited Company closed its accounting year on 30.6.2011 and the accounts for that period were considered and approved by the board of directors on 20th August, 2011. The company was engaged in laying pipe line for an oil company deep beneath the earth. While doing the boring work on 1.9.2011 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of Rs. 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.2011.

Solution

Para 3.2 of AS 4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date defines 'events occurring after the balance sheet date' as 'significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in the case of a company'. The given case is discussed in the light of the above mentioned definition and requirements given in paras 13-15 of the said AS 4 (Revised).

In this case the incidence, which was expected to push up cost became evident after the date of approval of the accounts. So that was not an 'event occurring after the balance sheet date'. However, this may be mentioned in the Directors' Report.

Illustration 4

While preparing its final accounts for the year ended 31st March, 2012 a company made a provision for bad debts @ 5% of its total debtors. In the last week of February, 2012 a debtor for Rs. 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2012 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2012?

Solution

As per paras 8.2 and 13 of Accounting Standard 4 on Contingencies and Events Occurring after the Balance Sheet Date, Assets and Liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist estimation of amounts relating to conditions existing at the balance sheet date.

So full provision for bad debt amounting to Rs. 2 lakhs should be made to cover the loss arising due to the insolvency

in the Final Accounts for the year ended 31st March, 2012. It is because earthquake took place before the balance sheet date.

Had the earthquake taken place after 31st March, 2012, then mere disclosure required as per para 15, would have been sufficient.

AS 5: Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

1. Net Profit or Loss for the Period

The net profit or loss for the period comprises the following components, each of which should be disclosed on the face of the statement of profit and loss:

a. Profit or loss from 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. For example profit on sale of merchandise, loss on sale of unsold stock at the end of the season.

b. Extraordinary items: Income or 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. For example, profit on sale of furniture or heavy loss of goods due to fire.

   Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived. Whether an event or transaction is clearly distinct from the ordinary activities of the enterprise is determined by the nature of the event or transaction in relation to the business ordinarily carried on by the enterprise rather than by the frequency with which such events are expected to occur. Therefore, an event or transaction may be extraordinary for one enterprise but not so for another enterprise because of the differences between their respective ordinary activities. For example, losses sustained as a result of an earthquake may qualify as an extraordinary item for many enterprises. However, claims from policyholders arising from an earthquake do not qualify as an extraordinary item for an insurance enterprise that insures against such risks.

   When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

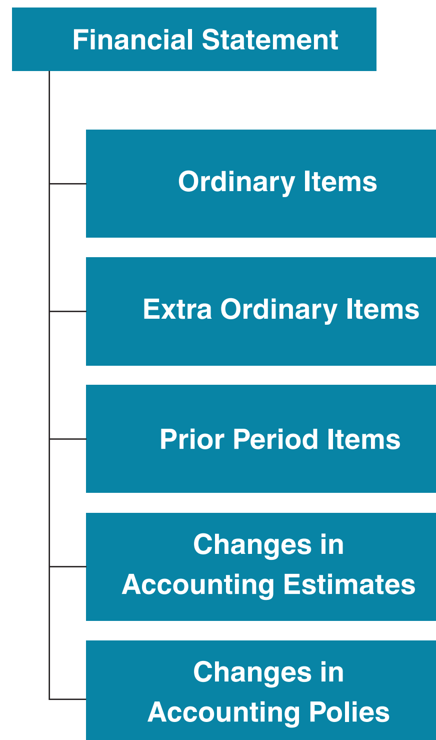
Circumstances which may give rise to the separate disclosure of items of income and expense include:

a. The write-down of inventories to net realisable value as well as the reversal of such write-downs.
b. A restructuring of the activities of an enterprise and the reversal of any provisions for the costs of restructuring.
c. Disposals of items of fixed assets.
d. Disposals of long-term investments.
e. Legislative changes having retrospective application.
f. Litigation settlements.

g. Other reversals of provisions.

2. Prior Period Items

Disclosure under Following Category



Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. Prior period items are generally infrequent in nature and can be distinguished from changes in accounting estimates.

Accounting estimates by their nature are approximations that may need revision as additional information becomes known. For example, income or expense recognised on the outcome of a contingency which previously could not be estimated reliably does not constitute a prior period item.

For example, Mr. Sachin purchased a new machine costing Rs. 10 lacs. Useful life was taken to be for 10 years therefore depreciation was charged at 10% on original cost each year. After 5 years when carrying amount was Rs. 5 lacs for the machine, management realizes that machine can work for another 2 years only and they decide to write off Rs. 2.5 lacs each year. This is not an example of prior period item but change in accounting estimate. In the same example management by mistake calculates the depreciation in the fifth year as 10% of Rs. 6,00,000 i.e. Rs. 60,000 instead of Rs. 1,00,000 and in the next year decides to write off Rs. 1,40,000. Rs. 1,00,000 current year's depreciation and Rs. 40,000 as prior period item.

3. Changes in Accounting Estimates

An estimate may have to be revised if changes occur in the circumstances based on which the estimate was made, or as a result of new information, more experience or subsequent developments. The revision of the estimate, by its nature, does not bring the adjustment within the definitions of an extraordinary item or a prior period item.

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

a. The period of the change, if the change affects the period only; or
b. The period of the change and future periods, if the change affects both.

To ensure the comparability of financial statements of different periods, the effect of a change in an accounting estimate which was previously included in the profit or loss from ordinary activities is included in that component of net profit or loss. The effect of a change in an accounting estimate that was previously included as an extraordinary item is reported as an extraordinary item.

4. 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. A change in an accounting policy should be made only if the adoption of a different accounting policy is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.

The following are not changes in accounting policies:

a. The adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, e.g., introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement;

b. The adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.

Any change in an accounting policy which has a material effect should be disclosed. The impact of, and the adjustments resulting from, such change, if material, should be shown in the financial statements of the period in which such change is made, to reflect the effect of such change. Where the effect of such change is not ascertainable, wholly or in part, the fact should be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

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.

Illustration 1

While preparing its final accounts for the year ended 31st March, 2012 Rainbow Limited created a provision for Bad and Doubtful debts are 2% on trade debtors. A few weeks later the company found that payments from some of the major debtors were not forthcoming. Consequently the company decided to increase the provision by 10% on the debtors as on 31st March, 2012 as the accounts were still open awaiting approval of the Board of Directors. Is this to be considered as an extra-ordinary item or prior period item? Comment.

Solution

The preparation of financial statements involve making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate does not bring the resulting amount within the definition either of prior period item or of an extraordinary item [para 21, AS 5 (Revised)].

In the given case, Rainbow Limited created a provision for bad and doubtful debts at 2% on trade debtors while preparing its final accounts for the year ended 31st March, 2012. Subsequently, the company decided to increase the provision by 10%. As per AS 5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item.

However, as per para 27 of AS 5 (Revised), a change in accounting estimate which has a material effect in the current period should be disclosed and quantified. Any change in an accounting estimate which is expected to have a material effect in later periods should also be disclosed.

Illustration 2

The company finds that the stock sheets of 31.3.2011 did not include two pages containing details of inventory worth Rs. 14.5 lakhs. State, how you will deal with the following matters in the accounts of Omega Ltd. for the year ended 31st March, 2012.

Solution

Paragraph 4 of Accounting Standard 5 on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, defines Prior Period items as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods”.

Rectification of error in stock valuation is a prior period item vide Para 4 of AS 5. Rs.14.5 lakhs must be added to the opening stock of 1.4.2011. It is also necessary to show Rs. 14.5 lakhs as a prior period adjustment in the Profit and loss Account below the line. Separate disclosure of this item as a prior period item is required as per Para 15 of AS 5.

AS 6: Depreciation Accounting

1. Depreciation

Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose useful life is predetermined.

2. Depreciable Assets

Depreciable assets are assets which

i. Are expected to be used during more than one accounting period. Dies and blocks are written off on first year itself as their useful life ends within one year.

ii. Have a limited useful life. Depreciation is not charged on land as the useful of land cannot be determined, it is endless.

iii. Are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business. Depreciation is not charged on assets purchased for the purpose of resale but could not be sold till the end of the accounting year.

3. Depreciable Amount

Depreciable amount of a depreciable asset is its historical cost, or other amount substituted for historical cost in the financial statements, less the estimated residual value.

Depreciable Amount = Historical Cost - Residual Value.

Assessment of depreciation and the amount to be charged in respect thereof in an accounting period are usually based on the following three factors:

i. Historical cost or other amount substituted for the historical cost of the depreciable asset when the asset has been revalued;

ii. Expected useful life of the depreciable asset; and

iii. Estimated residual value of the depreciable asset.

4. Historical Cost

Historical cost of a depreciable asset represents its money outlay or its equivalent in connection with its acquisition, installation and commissioning as well as for additions to or improvement thereof.

For example, Mr. Rahul imported machine from Germany on the condition that machine will be run on trail basis for 15 days, if machine works perfectly it will be purchased or else it will be rejected. Now since trial run is the necessary condition for acquisition of the machinery, the cost incurred for trail run net of any revenue generated will be capitalized i.e. added to the historical cost of the machine.

The historical cost of a depreciable asset may undergo subsequent changes arising as a result of increase or decrease in long term liability on account of exchange fluctuations, price adjustments, changes in duties or similar factors.

Illustration 1

Mr. X set up a new factory in the backward area and purchased plant for Rs. 500 lakhs for the purpose. Purchases

were entitled for the CENVAT credit of Rs. 10 lakhs and also Government agreed to extend the 25% subsidy for backward area development. Determine the depreciable value for the asset.

Solution

Particulars	Rs. in Lakhs
Cost of the plant	500
Less: CENVAT	(10)
	490
Less: Subsidy	(98)
Depreciable Value	392

5. Useful Life

Useful life of a depreciable asset is shorter than its physical life. Useful life depends upon the following factors

i. Pre-determined by legal or contractual limits
   Example- Asset given on lease, the estimated life is period of lease.
ii. Depends upon the number of shifts for which the asset is to be used.
iii. Repair and Maintenance policy of enterprise.
iv. Technological obsolescence
v. Innovation/ improvements in the production method.
vi. Change in demand of output.
vii. Legal or other restrictions.

Useful life is either

i. The period over which a depreciable asset is expected to be used by the enterprise; or
ii. The number of production or similar units expected to be obtained from the use of the asset by the enterprise.

6. Additions to Existing Assets

Any addition or extension to an existing asset which is of a capital nature and which becomes an integral part of the existing asset is depreciated over the remaining useful life of that asset. As a practical measure, however, depreciation is sometimes provided on such addition or extension at the rate which is applied to an existing asset. Any addition or extension which retains a separate identity and is capable of being used after the existing asset is disposed of, is depreciated independently on the basis of an estimate of its own useful life.

For example, the engine of an aircraft is replace, in this case since the life of engine is not depended on the life of the aircraft body, depreciation charged on both is recorded separately.

7. Amount of Depreciation

The quantum of depreciation to be provided in an accounting period involves the exercise of judgement by management in the light of technical, commercial, accounting and legal requirements and accordingly may need

periodical review. If it is considered that the original estimate of useful life of an asset requires any revision, the unamortised depreciable amount of the asset is charged to revenue over the revised remaining useful life.

8. Methods of Depreciation

There are several methods of allocating depreciation over the useful life of the assets. Those most commonly employed in industrial and commercial enterprises are the straight line method and the reducing balance method. The management of a business selects the most appropriate method(s) A combination of more than one method is sometimes used. In respect of depreciable assets which do not have material value, depreciation is often allocated fully in the accounting period in which they are acquired, e.g. books.

a. **Straight Line Method:** An equal amount is written off every year during the working life on an asset so as to reduce the cost of the asset to NIL or to its residual value at the end of its useful life.

$$\text{Straight Line Depreciation} = \frac{\text{Cost of Asset - Scrap Value}}{\text{Useful Life}}$$

$$\text{Depreciation Rate} = \frac{\text{Straight Line Depreciation x 100}}{\text{Cost of Asset}}$$

This method of charging depreciation is recommended mostly for power generating units or for the assets where danger of obselence is low.

b. **Reducing Balance/Written Down Value Method:** A fixed percentage of the diminishing value of the asset is written off each year so as to reduce the asset to its salvage value at the end of its life.

$$\text{Depreciation Rate} = \frac{1}{n}\left[\frac{\text{Residual Value}}{\text{Cost of Asset}} \text{ x } 100\right]$$

n = useful life.

This method is highly recommended mainly for manufacturing units though it is recommended for most of the enterprises.

Distinction between Straight Line and Written Down Value Method:

	Straight Line Method	Written Down Value
1.	Amount of depreciation is calculated at a fixed percentage on the original cost of the fixed asset.	Amount of depreciation is calculated at a fixed percentage on written down value of the fixed amount.
2.	Amount of depreciation remains same year to year.	Amount of depreciation decreases year to year.

3.	At the end of the life, the value of asset can be zero.	The value of assets never comes to zero.
4.	It is also known as Fixed Instalment Method or Constant Charge Method.	It is also known as Reducing or Diminishing Balance Method.
5.	It is easy to calculate.	It is difficult to calculate.
6.	Depreciation + Repair keeps increasing.	Depreciation + Repairs more or less remains constant.
7.	Suitable for the assets that requires fewer repairs.	Suitable for assets, which requires more repairs with passage of time.

c. **Sum of the Year Digit Method (SYD):** Under this method, the rate of depreciation is charged on the original cost. However, the rate of depreciation for each year is a fraction in which the denominator is the sum of the year digits from 1 to n and numerator for the first year is n, for the second year n-1, for the third year n-2 and so on.

$$\text{Rate of Depreciation for each year is} = \frac{n - (x - 1)}{n(n + 1)/2}$$

Where, n = useful life of the asset.
x = number of years asset is in use.

d. **Machine Hour Method:** Where it is practically possible to keep a record of the actual running hours of each machine, depreciation may be calculated on the basis of hours that the concerned machine worked.

$$\text{Depreciation for year 'n'} = \frac{\text{Hours worked in n x (Cost - Salvage Value)}}{\text{Total Estimated Working Hours}}$$

This method is recommended for the assets mainly machinery, where in the cost of the asset was determined mainly based on the useful working hours of the machine.

e. **Depletion Method:** This method is used in case of mines, quarries etc. containing only a certain quantity of product. The depreciation rate is calculated by dividing the cost of the asset by the estimated quantity of product likely to be available.

$$\text{Depreciation for year 'n'} = \frac{\text{Qty. Extracted / Produced 'n' x (Cost - Residual Value)}}{\text{Total Estimated Quantity}}$$

f. **Annuity Method:** This is a method of depreciation which also takes into account the element of interest on capital outlay and seeks to write off the value of the asset as well as the interest lost over the life of the asset. On

that basis, the amount of depreciation to be annually provided in the account is ascertained from the Annuity Tables. Though the amount written off annually is constant, the interest in the earlier years being greater, only small amount of the capital outlay is written off. This proportion is reversed with the passage of time.

This method of charging depreciation is mostly recommended for leasehold assets.

g. **Sinking Fund Method:** If the sum involved in replacing the asset is large, than just providing for depreciation will not be sufficient, as because the concern may not have the ready fund available to replace the assets. For this purpose a Sinking Fund Account is created, a depreciation amount is credited to it. The amount is invested in some Government Securities. Every year the process is repeated, the interest received from such securities are also reinvested and these securities are sold at the end of the life of the asset, so that the concern has the ready fund to replace the asset.

9. Basis for Computation of Depreciation

The statute governing an enterprise may provide the basis for computation of the depreciation. Where the management's estimate of the useful life of an asset of the enterprise is shorter than that envisaged under the provisions of the relevant statute, the depreciation provision is appropriately computed by applying a higher rate. If the management's estimate of the useful life of the asset is longer than that envisaged under the statute, depreciation rate lower than that envisaged by the statute can be applied only in accordance with requirements of the statute.

10. Disposal of Assets

Where depreciable assets are disposed of, discarded, demolished or destroyed, the net surplus or deficiency, if material, is disclosed separately.

11. Change in Method of Depreciation

When such a change in the method of depreciation is made, depreciation is recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective re-computation of depreciation in accordance with the new method is adjusted in the accounts in the year in which the method of depreciation is changed and it is charged or credited to Profit & Loss Account as per the case.

Such a change is treated as a change in accounting policy and its effect is quantified and disclosed.

Illustration 2

Mr. A purchased a machine on 01.04.2007 for Rs. 1,00,000. On 01.07.2008 he purchased another machine for Rs. 1,50,000. On 01.10.2009, he purchased the third machine for Rs. 2,00,000 and on 31.12.2010 he sold the second machine for Rs. 1,25,000. On 31.03.2012 he decided to change the method of charging depreciation from Straight Line Method @ 10% p.a. to Written Down Value Method @ 15%.

Solution

Working Note 1: Depreciation charged under old method:

Particulars	Rs.	Rs.
Purchase of first machine	100,000	
Depreciation for 4 years (1,00,000 x 10% x 4)		40,000
Purchase of third machine	200,000	
Depreciation for 1.5 years (2,00,000 x 10% x 1.5)		30,000
Total Depreciation charged		70,000

Working Note 2: Depreciation to be charged under new method:

Year	Opening WDV Rs.	Purchases Rs.	Balance Rs.	Depreciation Rs.	Closing WDV Rs.
2007-08	-	100,000	100,000	15,000	85,000
2008-09	85,000	-	85,000	12,750	72,250
2009-10	72,250	200,000	272,250	40,838	231,412
2010-11	231,412	-	231,412	34,712	196,700
		Total Depreciation		1,03,300	

Machine Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
01.04.2007	To Bank	1,00,000	31.03.2008	By Depreciation	10,000
				By Balance C/d.	90,000
		1,00,000			1,00,000
01.04.2008	To Balance B/d.	90,000	31.03.2009	By Depreciation	21,250
01.07.2008	To Bank	1,50,000		By Balance C/d.	2,18,750
		2,40,000			2,40,000
01.04.2009	To Balance B/d.	2,18,750	31.03.2010	By Depreciation	35,000
01.10.2009	To Bank	2,00,000		By Balance C/d.	3,83,750
		4,18,750			4,18,750
01.04.2010	To Balance B/d.	3,83,750	31.12.2010	By Bank	125,000
31.12.2010	To Profit on Sale	12,500	31.03.2011	By Depreciation	41,250
				By Balance C/d.	2,30,000
		3,96,250			3,96,250

01.04.2011	To Balance B/d.	2,30,000	31.03.2012	By Profit & Loss A/c.	33,300
				By Depreciation	29,505
				(1,96,700 x 15%)	1,67,195
		2,30,000		By Balance C/d.	2,30,000
01.04.2012	To Balance B/d.	1,67,195			

12. Disclosure

1. The depreciation methods used,

2. The total depreciation for the period for each class of assets,

3. The gross amount of each class of depreciable assets and the related accumulated depreciation are disclosed in the financial statements along with the disclosure of other accounting policies.

4. The depreciation rates or the useful lives of the assets are disclosed only if they are different from the principal rates specified in the statute governing the enterprise.

5. In case the depreciable assets are revalued, the provision for depreciation is based on the revalued amount on the estimate of the remaining useful life of such assets. In case the revaluation has a material effect on the amount of depreciation, the same is disclosed separately in the year in which revaluation is carried out.

A change in the method of depreciation is treated as a change in an accounting policy and is disclosed accordingly.

This statement was issued by ICAI in the year 1985 and in the initial years it was recommendatory for only level I enterprises and but was made mandatory for enterprise in India from April 01, 1993.

AS 9: Revenue Recognition

1. Revenue

Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. 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. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.

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

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

iv. Revenue of insurance companies arising from insurance contracts.

Examples of items not included within the definition of "revenue" for the purpose of this Statement are:

i. Realised gains resulting from the disposal of, and unrealised gains resulting from the holding of, non-current assets e.g. appreciation in the value of fixed assets;

ii. Unrealised holding gains resulting from the change in value of current assets, and the natural increases in herds and agricultural and forest products;

iii. Realised or unrealised gains resulting from changes in foreign exchange rates and adjustments arising on the translation of foreign currency financial statements;

iv. Realised gains resulting from the discharge of an obligation at less than its carrying amount;

v. Unrealised gains resulting from the restatement of the carrying amount of an obligation.

2. Sale of Goods

A key criterion for determining when to recognise revenue from a transaction involving the sale of goods is that the seller has transferred the property in the goods to the buyer for a consideration. The transfer of property in goods, in most cases, results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. However, there may be situations where transfer of property in goods does not coincide with the transfer of significant risks and rewards of ownership. Revenue in such situations is recognised at the time of transfer of significant risks and rewards of ownership to the buyer. At certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases when sale is assured under a forward contract or a government guarantee or where market exists and there is a negligible risk of failure to sell, the goods involved are often valued at net realisable value. Such amounts, while not revenue as defined in this Statement, are sometimes recognised in the statement of profit and loss and appropriately described.

3. Rendering of Services

Revenue from service transactions is usually recognised as the service is performed, either by the proportionate completion method or by the completed service contract method.

Proportionate completion method is a method of accounting which recognises revenue in the statement of profit and loss proportionately with the degree of completion of services under a contract. Here 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 is a method of accounting which recognises revenue in the statement of profit and loss only when the rendering of services under a contract is completed or substantially completed. In this method performance consists of the execution of a single act. Alternatively, services are performed in more than a single act, and the services yet to be performed are so significant in relation to the transaction taken as a whole that performance cannot be deemed to have been completed until the execution of those acts. The completed service contract method is relevant to these patterns of performance and accordingly revenue is recognised when the sole or final act takes place and the service becomes chargeable

4. Interest, Royalties and Dividends

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

i. Interest: charges for the use of cash resources or amounts due to the enterprise. Revenue is recognized on a time proportion basis taking into account the amount outstanding and the rate applicable. For example, debenture interest payable on every June 30th and December 31st. On March 31st when books will be closed, though interest has not fallen due but still interest for the period January, February and March will be recognised on time basis.

ii. Royalties: charges for the use of such assets as know-how, patents, trade marks and copyrights. Revenue is recognized on an accrual basis in accordance with the terms of the relevant agreement. If agreement is signed for royalty payable on the basis of the number of copies of the book published, it will be recognised on that basis only.

iii. Dividends: rewards from the holding of investments in shares. Revenue is recognized when the owner's right to receive payment is established. Unless company declare dividend on the shares, it is not certain. Therefore it is recognised only when directors actually decides to pay dividend to their shareholders.

5. Effect of Uncertainties on Revenue Recognition

Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. In such cases:

When the uncertainty relating to collectability arises subsequent to the time of sale or the rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

An essential criterion for the recognition of revenue is that the consideration receivable for the sale of goods, the rendering of services or from the use by others of enterprise resources is reasonably determinable. When such consideration is not determinable within reasonable limits, the recognition of revenue is postponed.

6. Disclosure

An enterprise should disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

The amount of turnover should be disclosed in the following manner on the face of the statement of profit and loss:

Turnover (Gross)	XXXXX
Less: Excise Duty	XXXXX
Turnover (Net)	XXXXX

The amount of excise duty to be shown as deduction from turnover should be the total excise duty for the year except the excise duty related to the difference between the closing stock and opening stock. The excise duty related to the difference between the closing stock and opening stock should be recognised separately in the statement of profit and loss, with an explanatory note in the notes to accounts to explain the nature of the two amounts of excise duty.

7. Illustrations

Illustration 1

The stages of production and sale of a producer are as follows (all in Rupees):

Stage	Activity	Costs to date	Net Realisable Value
A	Raw Materials	10,000	8,000
B	WIP 1	12,000	13,000
C	WIP 2	15,000	19,000
D	Finished Product	17,000	30,000
E	Ready for Sale	17,000	30,000
F	Sale Agreed	17,000	30,000
G	Delivered	18,000	30,000
H	Paid For	18,000	30,000

State and explain the stage at which you think revenue will be recognized and how much would be gross profit and net profit on a unit of this product?

Solution

According to AS - 9, sales will be recognized only 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 at Stage F when sales are agreed upon at a price and goods allocated for delivery purpose.

Gross Profit will be determined at Stage E, when goods are ready for sale after all necessary process for production is over i.e. Rs. 13,000 (30,000 - 17,000).

Net Profit will be determined at Stage H, when goods are delivered and payment collected i.e. Rs. 12,000 (30,000 - 18,000).

Illustration 2

A public sector company is trading gold in India for its customers, after purchasing gold the price of gold is fixed within 120 days as per rules and regulations of Indian Bullion Market by the customer. At the close of year, price of some gold was not fixed on March 31, 2012. The details are given below:

Quantity of Gold =	10,000 TT Bars
Gold Rate as on March 31, 2012 =	Rs. 275 per TT Bar
Gold Rate was fixed on June 26, 2012 before the finalization of accounts of company =	Rs. 273 per TT Bar

Calculate the amount of sales regarding 10,000 TT Bars to be booked in the company's account for the year ended March 31, 2012.

Solution

We need to refer to AS 5 along with AS 9 in this case, since gold is an item which has ready market hence they should be valued at the market price. So, as event occurring after the balance sheet date, the price of gold is fixed at Rs. 273 per TT Bar, gold will be valued at that rate.

Illustration 3

Y Co. Ltd., used certain resources of X Co. Ltd. In return X Co. Ltd. received Rs. 10 lakhs and Rs. 15 lakhs as interest and royalties respective from Y Co. Ltd. during the year 2011-12. You are required to state whether and on what basis these revenues can be recognised by X Co. Ltd.

Solution

As per para 13 of AS 9 on Revenue Recognition, revenue arising from the use by others of enterprise resources yielding interest and royalties should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following bases:

i. Interest: on a time proportion basis taking into account the amount outstanding and the rate applicable.
ii. Royalties: on an accrual basis in accordance with the terms of the relevant agreement.

Illustration 4

A claim lodged with the Railways in March, 2010 for loss of goods of Rs. 2,00,000 had been passed for payment in March, 2012 for Rs. 1,50,000. No entry was passed in the books of the Company, when the claim was lodged. Advise P Co. Ltd. about the treatment of the following in the Final Statement of Accounts for the year ended 31st March, 2012.

Solution

Prudence suggests non-consideration of claim as an asset in anticipation. So receipt of claims is generally recognised on cash basis. Para 9.2 of AS 9 on Revenue Recognition states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. Para 9.5 of AS 9 states that when recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised. In this case it may be assumed that collectability of claim was not certain in the earlier periods. This is supposed from the fact that only Rs. 1,50,000 were collected against a claim of Rs. 2,00,000. So this transaction can not be taken as a Prior Period Item.

In the light of revised AS 5, it will not be treated as extraordinary item. However, para 12 of AS 5 (Revised) states that when items of income and expense within profit or loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately as per para 12 of AS 5 (Revised).

AS 10: Accounting for Fixed Assets

1. Identification of Fixed Assets

Fixed asset is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business. Stand-by equipment and servicing equipment are normally capitalised. Machinery spares are usually charged to the profit and loss statement as and when consumed. However, if such spares can be used only in connection with an item of fixed asset, it may be appropriate to allocate the total cost on a systematic basis over a period not exceeding the useful life of the principal item.

2. Machinery Spares

Whether to capitalise a machinery spare or not will depend on the facts and circumstances of each case. However, the machinery spares of the following types should be capitalised being of the nature of capital spares/insurance spares -

Machinery spares which are specific to a particular item of fixed asset, i.e., they can be used only in connection with a particular item of the fixed asset and their use is expected to be irregular.

Machinery spares of the nature of capital spares/insurance spares should be capitalised separately at the time of their purchase whether procured at the time of purchase of the fixed asset concerned or subsequently. The total cost of such capital spares/insurance spares should be allocated on a systematic basis over a period not exceeding the useful life of the principal item, i.e., the fixed asset to which they relate.

When the related fixed asset is either discarded or sold, the written down value less disposal value, if any, of the capital spares/insurance spares should be written off.

The stand-by equipment is a separate fixed asset in its own right and should be depreciated like any other fixed asset.

3. Components of Cost

Gross book value of a fixed asset is its historical cost or other amount substituted for historical cost in the books of account or financial statements. When this amount is shown net of accumulated depreciation, it is termed as net book value. The cost of an item of fixed asset comprises

1. Its purchase price, including import duties and other non-refundable taxes or levies

2. Any directly attributable cost of bringing the asset to its working condition for its intended use;

3. The initial estimate of the costs of dismantling and removing the asset and restoring the site on which it is located, the obligation for which the enterprise incurred either when the item was acquired, or as a consequence of having used the asset during a particular period for purposes other than to produce inventories during that period.

   Any trade discounts and rebates are deducted in arriving at the purchase price. The cost of a fixed asset may undergo changes subsequent to its acquisition or construction on account of exchange fluctuations, price adjustments and changes in duties or similar factors.

The expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, is usually capitalised as an indirect element of the construction cost. If the interval between the date a project is ready to commence commercial production and the date at which commercial production actually begins is prolonged, all expenses incurred during this period are charged to the profit and loss statement.

4. Self-constructed Fixed Assets

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

The Standard states that if an enterprise makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing the asset for sale, in accordance with the principles of AS 2 Valuation of Inventories.

Administration and other general overhead costs are not a component of the cost of tangible fixed asset because they cannot be directly attributed to the acquisition of the asset or bringing the asset to its working condition.

The following principles also apply:

- any internal profits are eliminated in arriving at the cost of an asset;
- the costs of abnormal amounts of wasted material, labour or other resources incurred in the production of the self-constructed asset are excluded from its cost; and
- borrowing costs incurred during the period of production will be included in accordance with AS 16 'Borrowing Costs' if the self-constructed asset meets the definition of a qualifying asset

Illustration 1

ABC Ltd. is constructing a fixed asset. Following are the expenses incurred on the construction:

Materials	Rs. 10,00,000
Direct Expenses	Rs. 2,50,000
Total Direct Labour	Rs. 5,00,000
(1/10th of the total labour time was chargeable to the construction)	
Total office & administrative expenses	Rs. 8,00,000
(5% is chargeable to the construction)	
Depreciation on the assets used for the construction of this assets	Rs. 10,000

Calculate the cost of fixed assets.

Solution

Calculation of the cost of construction of Assets

Particulars	Rs.
Direct Materials	1,000,000
Direct Labour	50,000
Direct Expenses	250,000
Office & Administrative Expenses	40,000
Depreciation	10,000
Cost of the Asset	1,350,000

5. Non-monetary Consideration

When a fixed asset is acquired in exchange for another asset, its cost is usually determined by reference to the fair market value of the consideration given. It may be appropriate to consider also the fair market value of the asset acquired if this is more clearly evident. When a fixed asset is acquired in exchange for shares or other securities in the enterprise, it is usually recorded at its fair market value, or the fair market value of the securities issued, whichever is more clearly evident.

Fair market value is the price that would be agreed to in an open and unrestricted market between knowledgeable and willing parties dealing at arm's length who are fully informed and are not under any compulsion to transact.

6. Improvements and Repairs

Any expenditure that increase the future benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value, e.g., an increase in capacity. A computer with 20GB hard disk crashed and was replaced with a 80GB hard disk, will be capitalised and added to the cost of the computer. The cost of an addition or extension to an existing asset, which has a separate identity and is capable of being used after the existing asset is disposed of, is accounted for separately. Current engine of an aircraft replaced with the new one on being damaged beyond repairs will be treated as a separate asset, as it has its own separate identity.

7. Amount Substituted for Historical Cost (Revaluation)

When a tangible fixed asset is revalued, the entire class of tangible fixed assets to which that asset belongs is required to be revalued. Assets within a class of tangible fixed assets are revalued simultaneously to avoid selective revalution of assets and the reporting of amounts in the financial statements that are a mixture of costs and valuations at different dates. This is intended to prevent the distortions caused by selective use of revalution, so as to take credit for gains without acknowledging falls in the value of similar assets.

The revalued amounts of fixed assets are presented in financial statements either by restating both the gross book value and accumulated depreciation so as to give a net book value equal to the net revalued amount or by restating the net book value by adding therein the net increase on account of revaluation. Different bases of valuation are

sometimes used in the same financial statements to determine the book value of the separate items within each of the categories of fixed assets or for the different categories of fixed assets. In such cases, it is necessary to disclose the gross book value included on each basis. It is not appropriate for the revaluation of a class of assets to result in the net book value of that class being greater than the recoverable amount of the assets of that class. An increase in net book value arising on revaluation of fixed assets is normally credited directly to owner's interests under the heading of revaluation reserves and is regarded as not available for distribution. Journal entry is as follow:

Fixed Asset Account Dr.
To Revaluation Reserve Account

A decrease in net book value arising on revaluation of fixed assets is charged to profit and loss statement except that, to the extent that such a decrease is considered to be related to a previous increase on revaluation that is included in revaluation reserve.

For example, Journal entry for decrease in the value of the asset on revaluation from Rs. 1,00,000 to Rs. 70,000, if Revaluation Reserve is appearing at Rs. 10,000 will be done as:

Revaluation Reserve Account	Dr. Rs. 10,000	
Loss on Revaluation Account	Dr. Rs. 20,000	
To Fixed Assets Account		Rs. 30,000

8. Retirements and Disposals (Derecognition)

The carrying amount of a tangible fixed asset should be derecognised:

- on disposal; or
- when no future economic benefits are expected from its use or disposal

Items of fixed assets that have been retired from active use and are held for disposal are stated at the lower of their net book value and net realisable value and are shown separately in the financial statements. Any expected loss is recognised immediately in the profit and loss statement. On disposal of a previously revalued item of fixed asset, the difference between net disposal proceeds and the net book value is normally charged or credited to the profit and loss statement except that, to the extent such a loss is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it is charged directly to that account. The amount standing in revaluation reserve following the retirement or disposal of an asset which relates to that asset may be transferred to general reserve.

For example, the journal entries for the sale of an asset for Rs. 1,00,000 appearing in the books at Rs. 1,15,000, if Revaluation Reserve is appearing at Rs. 20,000 will be as follow:

Bank Account	Dr. Rs. 1,00,000	
Revaluation Reserve Account	Dr. Rs. 15,000	
To Fixed Assets Account		Rs. 1,15,000
Revaluation Reserve Account	Dr. Rs. 5,000	
To General Reserve Account		Rs. 5,000

9. Hire Purchases

In the case of fixed assets acquired on hire purchase terms, although legal ownership does not vest in the enterprise, such assets are recorded at their cash value, which, if not readily available, is calculated by assuming an appropriate rate of interest. They are shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof.

10. Joint Ownership

Where an enterprise owns fixed assets jointly with others, the extent of its share in such assets, and the proportion in the original cost, accumulated depreciation and written down value are stated in the balance sheet. Alternatively, the pro rata cost of such jointly owned assets is grouped together with similar fully owned assets. Details of such jointly owned assets are indicated separately in the fixed assets register.

11. Goodwill

Goodwill, in general, is recorded in the books only when some consideration in money or money's worth has been paid for it. As a matter of financial prudence, goodwill is written off over a period. However, many enterprises do not write off goodwill and retain it as an asset.

12. Disclosure

i. Gross and net book values of fixed assets at the beginning and end of an accounting period showing additions, disposals, acquisitions and other movements;

ii. Expenditure incurred on account of fixed assets in the course of construction or acquisition; and

iii. Revalued amounts substituted for historical costs of fixed assets, the method adopted to compute the revalued amounts, the nature of any indices used, the year of any appraisal made, and whether an external valuer was involved, in case where fixed assets are stated at revalued amounts.

13. Illustrations

Illustration 2

On March 01, 2012, X Ltd. purchased Rs. 5 lakhs worth of land for a factory site. Company demolished an old building on the property and sold the material for Rs. 10,000. Company incurred additional cost and realized salvaged proceeds during the March 2012 as follows:

Legal fees for purchase contract and recording ownership	Rs. 25,000
Title guarantee insurance	Rs. 10,000
Cost for demolition of building	Rs. 50,000

Compute the balance to be shown in the land account on March 31, 2012 balance sheet.

Solution

Calculation of the cost for Purchase of Land

Particulars		Rs.
Cost of Land		5,00,000
Legal Fees		25,000
Title Insurance		10,000
Cost of Demolition	50,000	
Less: Salvage value of Material	(10,000)	40,000
Cost of the Asset		5,75,000

Illustration 3

i. T. Ltd. imported fixed assets worth Rs. 1,000 lacs on 1.4.2011, when the exchange rate was Rs. 40 per US $. The assets were fully financed by foreign currency loan repayable in five equal annual installments. As on 31.3.2012, the first installment was paid at the Exchange Rate of Rs. 42.

ii. The company's fixed assets stood at Rs. 3,000 lacs as on 1.4.2011. It provides depreciation at 10% per annum under the WDV method. However it noticed that about Rs. 500 lacs worth of non-imported assets acquired on 1.4.2011 will be obsolete in 2 years time. It wants to write off these assets over 2 years.

iii. A few days after the beginning of the year, the company acquired assets for Rs. 500 lacs on which it received a government grant of 10%.

Prepare a schedule as on 31.3.2012 in respect of the above three categories of assets and support the schedule with relevant accounting standards.

Solution

In the Books of T Ltd.
Schedule of Fixed Assets as on 31st March, 2012

(Amount in Rs. lacs)

Fixed Assets	Gross Block (at cost)				Depreciation				Net Block	
	As at 1.4.11	Additions	Deductions	As at 31.3.12	Up to 31.3.11	For the year	On Deductions	Total upto 31.3.12	As at 31.3.12	As at 31.3.11
Imported Assets	–	1,000	–	1,000	–	100	–	100	900	–
Non - Imported Assets (acquired on 1.4.2009)	–	500	–	500	–	250	–	250	250	–
Other Assets	3,000	450	–	3,450	–	345	–	345	3,105	3,000
Total	3,000	1,950	–	4,950	–	695	–	695	4,255	3,000

1. As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as income/expense in the period in which they arise.

   Calculation of Exchange Difference:

   Foreign currency loan $= \frac{1000 \text{ lacs}}{40}$

   = 25 lacs US $

   Exchange difference = 25 lacs US $ × (42 - 40)
   = Rs. 50 lacs (including exchange loss on payment of first instalment)

   Thus, exchange loss of Rs. 50 lakhs should be recognized as expense in the profit and loss account for the year ended 31st March, 2012.

2. It was noticed that about Rs. 500 lacs worth of non-imported assets acquired on 1.4.2011 will be obsolete in two years time. Hence, these assets have been written off at the rate of 50%.

3. Para 14 of AS 12 on Accounting for Government Grants regards two methods of presentation of grants related to specific fixed assets in financial statements. Under the first method which has been applied in the given case, the grant is shown as a deduction from the gross value of the fixed assets in arriving at its book value. Thus, only 90% of the cost of fixed assets has been shown as addition after adjusting the grant amount.

   Alternatively, the grant can be treated as a deferred income which should be recognised in the profit and loss statement over the useful life of fixed assets in the proportions in which depreciation on the assets will be charged.

   Note: As regards fixed assets standing at Rs. 3,000 lacs as on 1.4.2011, in the absence of information in respect of cost and depreciation amount provided upto 31.3.2011, the entire given amount has been shown under gross block as at 1.4.2011.

AS 11: Accounting for the Effect of Changes in Foreign Exchange Rates

1. Scope

This Statement should be applied:

a. In accounting for transactions in foreign currencies.

b. In translating the financial statements of foreign operations.

c. This Statement also deals with accounting for foreign currency transactions in the nature of forward exchange contracts.

This Statement does not:

a. 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 it uses a different currency, the Standard requires disclosure of the reasons for using that currency. The Standard also requires disclosure of the reason for any change in the reporting currency.

b. Deal with the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation which are addressed in AS 3 Cash flow statement.

c. Deal with exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

d. Deal with the restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purposes.

2. Definitions of the Terms Used in the Standard

A foreign currency transaction is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when an enterprise either:

a. 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.

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money. For example, cash, receivables and payables.

Non-monetary items are assets and liabilities other than monetary items. For example, fixed assets, inventories and investments in equity shares.

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.

Integral foreign operation is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations.

Non-integral foreign operation is a foreign operation that is not an integral foreign operation. When there is a change in the exchange rate between the reporting currency and the local currency, there is little or no direct effect on the present and future cash flows from operations of either the non-integral foreign operation or the reporting enterprise. The change in the exchange rate affects the reporting enterprise's net investment in the non-integral foreign operation rather than the individual monetary and non-monetary items held by the non-integral foreign operation.

'Net investment in a non-integral foreign operation' is the reporting enterprise's share in the net assets of that

operation.

Forward exchange contract means an agreement to exchange different currencies at a forward rate.

Forward rate is the specified exchange rate for exchange of two currencies at a specified future date.

'Foreign currency' is a currency other than the reporting currency of an enterprise

3. Initial Recognition

A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.

A rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

4. Reporting at each Balance Sheet Date

The treatment of foreign currency items at the balance sheet date depends on whether the item is:

- monetary or non-monetary; and
- carried at historical cost or fair value (for non-monetary items).

a. Foreign currency monetary items should be reported using the closing rate. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date, e.g., where there are restrictions on remittances or where the closing rate is unrealistic and it is not possible to effect an exchange of currencies at that rate at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from or required to disburse, such item at the balance sheet date.

b. Non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction.

c. Non-monetary items which are carried at fair value or other similar valuation denominated in a foreign currency should be reported using the exchange rates that existed when the values were determined.

d. The contingent liability denominated in foreign currency at the balance sheet date is disclosed by using the closing rate.

5. Recognition of Exchange Differences

Exchange differences arise on:

- the settlement of monetary items at a date subsequent to intial recognition; and

- remeasuring an enterprise's monetary items at rates different from those at which they were either initially recorded (if in the period) or previously recorded (at the previous balance sheet date).

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. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognised in each intervening period up to the period of settlement is determined by the change in exchange rates during that period.

6. 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. For this purpose, foreign operations are classified as either 'integral foreign operations' or 'non-integral foreign operations'.

An integral foreign operation 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. In such cases, a change in the exchange rate between the reporting currency and the currency in the country of foreign operation has an almost immediate effect on the reporting enterprise's cash flow from operations. Therefore, the change in the exchange rate affects the individual monetary items held by the foreign operation rather than the reporting enterprise's net investment in that operation.

In contrast, a non-integral foreign operation accumulates cash and other monetary items, incurs expenses, generates income and perhaps arranges borrowings, all substantially in its local currency. It may also enter into transctions in foreign currencies, including transactions in the reporting currency. When there is a change in the exchange rate between the reporting currency and the local currency, there is little or no direct effect on the present and future cash flows from operations of either the non-integral foreign operation or the reporting enterprise. The change in the exchange rate affects the reporting enterprise's net investment in the non-integral foreign operation rather than the individual monetary and non- monetary items held by the non-integral foreign operation.

7. Translation of Foreign Integral Operations

The individual items in the financial statements of the foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself. The cost and depreciation of tangible fixed assets is translated using the exchange rate at the date of purchase of the asset or, if the asset is carried at fair value or other similar valuation, using the rate that existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when those costs were incurred. The recoverable amount or realisable value of an asset is translated using the exchange rate that existed when the recoverable amount or net realisable value was determined. For example, when the net realisable value of an item of inventory is determined in a foreign currency, that value is translated using the exchange rate at the date as at which the net realisable value is determined. The rate used is therefore usually the closing rate.

8. Translation of Non-integral Foreign Integral Operations

The translation of the financial statements of a non-integral foreign operation is done using the 'closing rate method' in which the following procedures are used:

a. The assets and liabilities, both monetary and non-monetary, of the non-integral foreign operation should be translated at the closing rate;

b. Income and expense items of the non-integral foreign operation should be translated at exchange rates at the dates of the transactions; and

c. All resulting exchange differences should be accumulated in a foreign currency translation reserve until the disposal of the net investment.

d. For practical reasons, a rate that approximates the actual exchange rates, for example an average rate for the period is often used to translate income and expense items of a foreign operation.

e. Any goodwill or capital reserve arising on the acquisition of a non-integral foreign operation is translated at the closing rate.

f. A contingent liability disclosed in the financial statements of a non-integral foreign operation is translated at the closing rate for its disclosure in the financial statements of the reporting enterprise.

g. The incorporation of the financial statements of a non-integral foreign operation in those of the reporting enterprise follows normal consolidation procedures, such as the elimination of intra-group balances and intra-group transactions of a subsidiary (AS 21 and AS 27). However, an 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 because the monetary item represents a commitment to convert one currency into another and exposes the reporting enterprise to a gain or loss through currency fluctuations.

h. 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 non-integral foreign operation often prepares, for purposes of incorporation in the financial statements of the reporting enterprise, statements as at the same date as the reporting enterprise (AS 21).

i. The exchange differences are not recognised as income or expenses for the period because the changes in the exchange rates have little or no direct effect on the present and future cash flows from operations of either the non-integral foreign operation or the reporting enterprise. When a non-integral foreign operation is consolidated but is not wholly owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and reported as part of, the minority interest in the consolidated balance sheet.

j. An enterprise may dispose of its interest in a non-integral foreign operation through sale, liquidation, repayment of share capital, or abandonment of all, or part of, that operation. The payment of a dividend forms part of a disposal only when it constitutes a return of the investment. In the case of a partial disposal, only the

proportionate share of the related accumulated exchange differences is included in the gain or loss. 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.

The following are indications that a foreign operation is a non-integral foreign operation rather than an integral foreign operation:

a. While the reporting enterprise may control the foreign operation, the activities of the foreign operation are carried out with a significant degree of autonomy from those of the reporting enterprise.

b. Transactions with the reporting enterprise are not a high proportion of the foreign operation's activities.

c. The activities of the foreign operation are financed mainly from its own operations or local borrowings rather than from the reporting enterprise.

d. Costs of labour, material and other components of the foreign operation's products or services are primarily paid or settled in the local currency rather than in the reporting currency.

e. The foreign operation's sales are mainly in currencies other than the reporting currency.

f. Cash flows of the reporting enterprise are insulated from the day-to-day activities of the foreign operation rather than being directly affected by the activities of the foreign operation.

g. Sales prices for the foreign operation's products are not primarily responsive on a short-term basis to changes in exchange rates but are determined more by local competition or local government regulation.

h. There is an active local sales market for the foreign operation's products, although there also might be significant amounts of exports.

9. Change in the Classification of a Foreign Operation

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.

10. 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.

11. Forward Exchange Contract

An enterprise may enter into a forward exchange contract or another financial instrument that is in substance a forward exchange contract, which is not intended for trading or speculation purposes, to establish the amount of the reporting currency required or available at the settlement date of a transaction. The premium or discount arising at the inception of such a forward exchange contract should be amortised as expense or income over the life of the contract.

Exchange differences on such a contract should be recognised in the statement of profit and loss in the reporting period in which the exchange rates change. Any profit or loss arising on cancellation or renewal of such a forward exchange contract should be recognised as income or as expense for the period.

In recording a forward exchange contract intended for trading or speculation purposes, the premium or discount on the contract is ignored and at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss on the contract is recognised.

Illustration 1

Mr. A bought a forward contract for three months of US$ 1,00,000 on 1st December at 1 US$ = Rs. 47.10 when exchange rate was US$ 1 = Rs. 47.02. On 31st December when he closed his books exchange rate was US$ 1 = Rs. 47.15. On 31st January, he decided to sell the contract at Rs. 47.18 per dollar. Show how the profits from contract will be recognized in the books.

Solution

Since the forward contract was for speculation purpose the premium on contract i.e. the difference between the spot rate and contract rate will not be recorded in the books. Only when the contract is sold the difference between the contract rate and sale rate will be recorded in the Profit & Loss Account.

Sale Rate	Rs. 47.18
Less: Contract Rate	(Rs. 47.10)
Premium on Contract	Rs. 0.08
Contract Amount	US$ 1,00,000
Total Profit (1,00,000 x 0.08)	Rs. 8,000

12. 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 reserve 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.

Illustration 2

A Ltd. purchased fixed assets costing Rs. 3,000 lakhs on 1.1.2011 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = Rs. 40.00 and Rs. 42.50 as on 1.1.2011 and 31.12.2011 respectively. First instalment was paid on 31.12.2011. The entire difference in foreign exchange has been capitalized.

You are required to state, how these transactions would be accounted for.

Solution

As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as income or expense.

Calculation of Exchange Difference:

For currency loan = $\frac{\text{3000 lakhs}}{40}$ = 75 lakhs US Dollers

Exchange difference = 75 lakhs US Dollars (42.50 - 40.00)
= Rs. 187.50 lakhs
(including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting Rs. 187.50 lakhs should be charged to profit and loss account for the year.

AS 12: Accounting For Government Grants

1. Introduction

AS 12 deals with accounting for government grants like subsidies, cash incentives, duty drawbacks, etc. and specifies that the government grants should not be recognized until there is reasonable assurance that the enterprise will comply with the conditions attached to them, and the grant will be received. The standard also describes the treatment of non-monetary government grants; presentation of grants related to specific fixed assets, related to

revenue, related to promoters' contribution; treatment for refund of government grants etc. The enterprises are required to disclose

i. the accounting policy adopted for government grants including the methods of presentation in the financial statements;

ii. the nature and extent of government grants recognized in the financial statements, including non-monetary grants of assets given either at a concessional rate or free of cost.

This Statement does not deal with:

i. The special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature.

ii. Government assistance other than in the form of government grants.

iii. Government participation in the ownership of the enterprise.

The receipt of government grants by an enterprise is significant for preparation of the financial statements for two reasons. Firstly, if a government grant has been received, an appropriate method of accounting therefore is necessary. Secondly, it is desirable to give an indication of the extent to which the enterprise has benefited from such grant during the reporting period. This facilitates comparison of an enterprise's financial statements with those of prior periods and with those of other enterprises.

2. Accounting Treatment of Government Grants

Two broad approaches may be followed for the accounting treatment of government grants:

- the 'capital approach', under which a grant is treated as part of shareholders' funds, and
- the 'income approach', under which a grant is taken to income over one or more periods.

Those in support of the 'capital approach' argue as follows:

i. Many government grants are in the nature of promoters' contribution, i.e., they are given by way of contribution towards its total capital outlay and no repayment is ordinarily expected in the case of such grants.

ii. They are not earned but represent an incentive provided by government without related costs.

Arguments in support of the 'income approach' are as follows:

i. The enterprise earns grants through compliance with their conditions and meeting the envisaged obligations. They should therefore be taken to income and matched with the associated costs which the grant is intended to compensate.

ii. As income tax and other taxes are charges against income, it is logical to deal also with government grants, which are an extension of fiscal policies, in the profit and loss statement.

iii. In case grants are credited to shareholders' funds, no correlation is done between the accounting treatment of

the grant and the accounting treatment of the expenditure to which the grant relates.

It is generally considered appropriate that accounting for government grant should be based on the nature of the relevant grant. Grants which have the characteristics similar to those of promoters' contribution should be treated as part of shareholders' funds. Income approach may be more appropriate in the case of other grants.

3. Recognition of Government Grants

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

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

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

4. Non-monetary Government Grants

Government grants may take the form of non-monetary assets, such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary assets given free of cost are recorded at a nominal value.

5. Presentation of Grants Related to Specific Fixed Assets

Two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives.

Under one method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.

Under the other method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets. However, if a grant related to a non-depreciable asset requires the fulfilment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income is suitably disclosed in the balance sheet after 'Reserves and Surplus' but before 'Secured Loans' with a suitable description, e.g., 'Deferred government grants'.

6. Presentation of Grants Related to Revenue

AS 12 permits two methods of presentation in the financial statements for grants related to income:

1. directly as a credit to the statement of profit and loss, either separately or under a general heading such as 'other income'; or

2. as a deduction in reporting the related expense.

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

Where the government grants are of the nature of promoters' contribution, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

8. Refund of Government Grants

Government grants sometimes become refundable because certain conditions are not fulfilled and are treated as an extraordinary item (AS 5).

The amount refundable in respect of a government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

The amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable.

Where a grant which is in the nature of promoters' contribution becomes refundable, in part or in full, to the government on non-fulfilment of some specified conditions, the relevant amount recoverable by the government is reduced from the capital reserve.

9. Disclosure

i. The accounting policy adopted for government grants, including the methods of presentation in the financial statements;

ii. 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.

Illustration 1

Sagar Limited belongs to the engineering industry. The Chief Accountant has prepared the draft accounts for the year ended 31.03.2012. You are required to advise the company on the following item from the viewpoint of finalisation of accounts, taking note of the mandatory accounting standards:

The company purchased on 01.04.2011 special purpose machinery for Rs. 25 lakhs. It received a Central Government Grant for 20% of the price. The machine has an effective life of 10 years.

Solution

AS 12 'Accounting for Government Grants' regards two methods of presentation, of grants related to specific fixed assets, in financial statements as acceptable alternatives. Under the first method, the grant can be shown as a deduction from the gross book value of the machinery in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge.

Under the second method, it can be treated as deferred income which should be recognised in the profit and loss statement over the useful life of 10 years in the proportions in which depreciation on machinery will be charged. The deferred income pending its apportionment to profit and loss account should be disclosed in the balance sheet with a suitable description e.g., 'Deferred government grants' to be shown after 'Reserves and Surplus' but before 'Secured Loans'.

The following should also be disclosed:

i. the accounting policy adopted for government grants, including the methods of presentation in the financial statements;

ii. the nature and extent of government grants recognised in the financial statement of Rs. 6 lakhs is required to be credited to the profit and loss statement of the current year.

Illustration 2

On 1.4.2009, ABC Ltd. received Government grant of Rs. 300 lakhs for acquisition of a machinery costing Rs. 1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 2012 due to non-fulfillment of certain conditions.

How you would deal with the refund of grant in the books of ABC Ltd.?

Solution

According to para 21 of AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. The accounting treatment in both the alternatives can be given as follows:

Alternative 1:

		Rs. in lakhs
1st April, 2009	Acquisition cost of machinery (Rs. 1,500 – Rs. 300)	1,200.00
31st March, 2010	Less: Depreciation @ 20%	(240.00)
	Book value	960.00
31st March, 2011	Less: Depreciation @ 20%	(192.00)
	Book value	768.00
31st March, 2012	Less: Depreciation @ 20%	(153.60)
1st April, 2012	Book value	614.40
May, 2012	Add: Refund of grant	300.00
	Revised book value	914.40

Depreciation @ 20% on the revised book value amounting Rs. 914.40 lakhs is to be provided prospectively over the residual useful life of the asset i.e. years ended 31st March, 2013 and 31st March, 2014.

Alternative 2:
ABC Ltd. can also debit the refund amount of Rs. 300 lakhs in capital reserve of the company.

AS 13: Accounting for Investments

1. Definition of the Terms Used in the Standard

Investments are assets held by an enterprise for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise. Assets held as stock-in-trade are not 'investments'

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. Under appropriate circumstances, market value or net realisable value provides an evidence of fair value.

Market value is the amount obtainable from the sale of an investment in an open market, net of expenses necessarily to be incurred on or before disposal.

2. Forms of Investments

Enterprises hold investments for diverse reasons. For some enterprises, investment activity is a significant element of operations, and assessment of the performance of the enterprise may largely, or solely, depend on the reported results of this activity. Some investments have no physical existence and are represented merely by certificates or similar documents (e.g., shares) while others exist in a physical form (e.g., buildings).For some investments, an active market exists from which a market value can be established. For other investments, an active market does not exist and other means are used to determine fair value.

3. Classification of Investments

A current investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made. The intention to hold for not more than one year is to be judged at the time of purchase of investment.

A long term investment is an investment other than a current investment.

4. Cost of Investments

The cost of an investment includes acquisition charges such as brokerage, fees and duties etc. If an investment is acquired, or partly acquired, by the issue of shares or other securities or other assets, the acquisition cost is the fair value of the securities issued or assets given up. The fair value may not necessarily be equal to the nominal or par value of the securities issued. It may be appropriate to consider the fair value of the investment acquired if it is more clearly evident.

Interest, dividends and rentals receivables in connection with an investment are generally regarded as income,

being the return on the investment. However, in some circumstances, such inflows represent a recovery of cost and do not form part of income. If it is difficult to make such an allocation except on an arbitrary basis, the cost of investment is normally reduced by dividends receivable only if they clearly represent a recovery of a part of the cost.

When right shares offered are subscribed for, the cost of the right shares is added to the carrying amount of the original holding. If rights are not subscribed for but are sold in the market, the sale proceeds are taken to the profit and loss statement. However, 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.

5. Carrying Amount of Investments

The carrying amount for current investments is the lower of cost and fair value.

Any reduction in realisable value is debited to profit and loss account, however if realisable value of investment is increased subsequently, the increase in value of current investment to the level of the cost is credited to profit and loss account.

Long-term investments are usually carried at cost. Where there is a decline, other than temporary, in the carrying amounts of long term valued investments, the resultant reduction in the carrying amount is charged to the profit and loss statement. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.

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. 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

On disposal of an investment, the difference between the carrying amount and the disposal proceeds, net of expenses, is recognised in the profit and loss statement. When disposing of a part of the holding of an individual investment, the carrying amount to be allocated to that part is to be determined on the basis of the average carrying amount of the total holding of the investment.

8. Reclassification of Investments

Where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

Where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.

9. Disclosure

The following disclosures in financial statements in relation to investments are appropriate: -

a. The accounting policies followed for valuation of investments.

b. The amounts included in profit and loss statement for:

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

   ii. Profits and losses on disposal of current investments and changes in carrying amount of such investments.

   iii. Profits and losses on disposal of long term investments and changes in the carrying amount of such investments.

c. Significant restrictions on the right of ownership, realisability of investments or the remittance of income and proceeds of disposal.

d. The aggregate amount of quoted and unquoted securities separately.

e. Other disclosures as specifically required by the relevant statute governing the enterprise.

Illustration 1

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, 2012 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. How will you deal with this in preparing the financial statements of R Ltd. for the year ended 31st March, 2012?

Solution

As it is stated in the question that financial statements for the year ended 31st March, 2012 are under preparation, the views have been given on the basis that the financial statements are yet to be completed and approved by the Board of Directors.

Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. Para 17 of AS 13 'Accounting for Investments' states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On these bases, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to Rs. 20,000 in the financial statements for the year ended 31st March, 2012.

AS 15: Employee Benefits

1. Introduction

Employee benefits include:

a. Short-term employee benefits (e.g. wages, salaries, paid annual leave and sick leave, profit sharing bonuses etc.(payable within 12 months of the year-end) and non-monetary benefits for current employees;

b. Post-employment benefits (e.g., gratuity, pension, provident fund, post-employment medical care etc.);

c. long-term employee benefits (e.g., long-service leave, long-term disability benefits, bonuses not wholly payable within 12 months of the year end etc.); and

d. termination benefits (e.g. VRS payments)

The Standard lays down recognition and measurement criteria and disclosure requirements for the above four types of employee benefits separately.

2. Meaning of the Term "Employee Benefits"

The term employee is not defined under the standard AS 15 does not define who is an 'employee', but states in that: "An employee may provide services to an entity on a full-time, part-time, permanent, casual or temporary basis. For the purpose of this Standard, employees include directors and other management personnel". This suggests that the intention was for the term 'employee' to apply more widely than simply to persons with a contract of employment as 'casual' and 'temporary' staff may frequently not have such contracts.

The following indicators may suggest an employee relationship may be more likely to exist, and may help in making individual judgements:

- A contract of employment exists;
- Individuals are considered employees for legal/tax/social security purposes;
- There is a large amount of oversight and direction by the employer and necessary tools, equipment and materials are provided by the employer;
- Services are performed at a location specified by the employer;

Services provided through an entity are in substance services provided by a specific individual, indications of which could be that the entity:

- Has no other clients;
- Has served the employer for a long period;
- Faces little or no financial risk;
- Requires the explicit permissions of the employer to concurrently undertake additional employment elsewhere.

3. Short-term Employee Benefits

Short-term employee benefits (other than termination benefits) are payable within twelve months after the end of the period in which the service is rendered. Accounting for these benefits is generally straightforward because no

actuarial assumptions are required to measure the obligation or cost. Short-term employee benefits are broadly classified into four categories:

i. regular period benefits (e.g., wages, salaries);

ii. short-term compensated absences (e.g., paid annual leave, maternity leave, sick leave etc.);

iii. profit sharing and bonuses payable within twelve months after the end of the period in which employee render the related services and

iv. non-monetary benefits (e.g., medical care, housing, cars etc.)

The Standard lays down a general recognition criteria for all short-term employee benefits. There are further requirements in respect of short-term compensated absences and profit sharing and bonus plans. The general criteria says that an enterprise should recognize as an expense (unless another accounting standard permits a different treatment) the undiscounted amount of all short-term employee benefits attributable to services that been already rendered in the period and any difference between the amount of expenses so recognized and cash payments made during the period should be treated as a liability or prepayment (asset) as appropriate.

The expected cost of accumulating compensated absences should be recognized when employees render the service that increase their entitlement to future compensated absences. 'An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date'. No distinction should be made between vesting and non-vesting entitlements. However, in measuring non-vesting entitlements, the possibility of employees leaving the enterprise before receiving them should be taken into account.

Non-accumulating compensated absences (e.g., maternity leave) do not carry forward and are not directly linked to the services rendered by employees in the past. Therefore, an enterprise recognizes no liability or expense until the time of the absence. In other words the cost of non-accumulating absences should be recognized as and when they arise.

Recognition of expenses for profit sharing and bonus plans would depend on fulfillment of conditions mentioned the Standard. The conditions are:

a. Enterprise has a present obligation to make such payments as a result of past events; and

b. Reliable estimate of the obligation can be made.

The second condition can be satisfied only when the profit sharing and bonus plans contained a formula for determining the amount of benefit. The enterprise should recognize the expected cost of profit sharing and bonus payments in the financial statements.

4. Post Employment Benefits: Defined Contribution vs. Defined Benefits

The accounting treatment and disclosures required for a post-employment benefit plan depend upon whether it is a defined contribution or a defined benefit plan. In addition to addressing defined contribution and defined benefit plans generally, the Standard also gives guidance as to how its requirements should be applied to insured benefits, multi-employment benefit plans. Defined contribution plans are post-employment benefit plans under which an enterprise pays fixed contributions into a separate fund and will have no obligation to pay further contributions. Under defined contribution plans, actuarial risk (that benefits will be less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee. In defined benefits plans, the actuarial and investment risk fall on the employer.

Defined benefit plans are post-employment benefit plans other than defined contribution plans.

In defined contribution plans, the contribution is charged to income statement, whereas in defined benefit plans, detailed actuarial calculation is performed to determine the charge.

5. Is the Gratuity Scheme a Defined Contribution or Defined Benefit Scheme?

An enterprise may pay insurance premiums to fund a post-employment benefit plan. The enterprise should treat such a plan as a defined contribution plan unless the enterprise will have an obligation to either:

a. pay the employee benefits directly when they fall due;

b. pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.

On the asset side, a question arises as to whether the funds under the scheme as certified by LIC would be treated as plan assets or reimbursement rights. The distinction is important (though both are measured on fair valuation basis) because plan assets are reduced from the defined benefit obligation and the net amount is disclosed in the balance sheet, whereas, in the case of reimbursement rights, the defined benefit obligation and the reimbursement rights are shown separately as liability and asset on the balance sheet. This would have the impact of making the balance sheet heavy both on the asset side as well as the liabilities side.

6. Other Long Term Employee Benefits

Other long-term employee benefits include, for example:

a. long-term compensated absences such as long-service or sabbatical leave;

b. jubilee or other long-service benefits;

c. long-term disability benefits;

d. profit-sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related services and

e. deferred compensation paid twelve months or more after the end of the period in which it is earned.

7. Termination Benefits

Termination Benefits are employee benefits payable as a result of either an enterprise's decision to terminate an employee's employment before the normal retirement date or an employee's decision to accept voluntary redundancy in exchange for those benefits (e.g., payments under VRS). Termination benefits are recognized by an enterprise as a liability and an expense only when the enterprise has

i. a detailed formal plan for the termination which is duly approved, and

ii. a reliable estimate can be made of the amount of the obligation.

Where the termination benefits fall due within twelve months after the balance sheet date, an undiscounted amount of such benefits should be recognized as liability in the balance sheet with a corresponding charge to Profit & Loss Account. However, when the termination benefits fall due more than twelve months after the balance sheet date, such benefits should be discounted using an appropriate discount rate. Where an offer has been made to encourage voluntary redundancy, the termination benefits should be measured by reference to the number of employees expected to accept the offer. Where there is uncertainty with regard to the number of employees who will accept an offer of voluntary redundancy, a contingent liability exists and should be so disclosed as per AS 29 'Provisions, Contingent Liabilities and Contingent Assets'.

8. Accounting Treatment

In the Balance Sheet of the enterprise, 'the amount recognized as a defined benefit liability should be the net total of the following amounts:

a. the present value of the defined benefit obligation at the balance sheet date;

b. minus any past service cost not yet recognized;

c. minus the fair value at the balance sheet date of plan assets (if any) out of which the obligations are to be settled directly.'

In case where fair value of plan assets is high, it may so happen that the net amount under defined benefit liability turns negative (giving rise to net assets). A S 15 states that the enterprise, in such a situation, should measure the resulting asset at the lower of:-

i. the amount so determined; and

ii. the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The recognition of expenses relating to defined benefits in the Profit and Loss Account is stated in Para 61 of the Standard. The Standard identifies seven components of defined employee benefit costs:

a. current service cost;
b. interest cost;
c. the expected return on any plan assets (and any reimbursement rights);
d. actuarial gains and losses (to the extent they are recognized);
e. past service cost (to the extent they are recognized);
f. the effect of any curtailments or settlements; and
g. the extent to which the negative net amount of defined benefit liability exceeds the amount mentioned in Para 59(ii) of the Standard.

The item (f) above needs explanation. 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. For example, the commuted portion of pension. A curtailment occurs when an employer either commits to reduce the number of employees covered by a plan or reduces the benefits under a plan. The gains or losses on the settlement or curtailment of a defined benefit plan should be recognized when the settlement or curtailment occurs.

9. Disclosures

Where there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists.

As required by AS 29, "Provisions, Contingent Liabilities and Contingent Assets" an enterprise discloses information about the contingent liability unless the possibility of an outflow in settlement is remote.

As required by AS 5, "Net Profit or Loss for the Period, Prior Period items and Changes in Accounting Policies" an enterprise discloses the nature and amount of an expense if it is of such size, nature or incidence that its disclosure is relevant to explain the performance of the enterprise for the period.

Termination benefits may result in an expense needing disclosure in order to comply with this requirement.

Where required by AS 18, "Related Party Disclosures", an enterprise discloses information about termination benefits for key management personnel

When drafting AS 15 (revised), the standard setters felt that merely on the basis of a detailed formal plan, it would not be appropriate to recognise a provision since a liability cannot be considered to be crystallized at this stage. See Chart 5 for its recognition ans measurement as per the standard. Accordingly, the revised AS 15 (2005) requires more certainty for recognition of termination cost, for example, if the employee has sign up for the termination scheme.

As per the transitional provision of revised AS 15, as regards VRS as paid upto 31 March, 2009, there is a choice to defer it over pay back period, subject to prohibition on carry forward to periods commencing on or after 1 April, 2010.

10. Actuarial Assumptions

The actuarial assumptions should be unbiased and mutually compatible. They are an enterprise's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits. They should be neither

imprudent nor excessively conservative, and should reflect the economic relationships between factors such as inflation, rates of salary increase, return on plan assets and discount rates.

AS 15 explains that actuarial assumptions comprise:

a. demographic assumptions about the future characteristics of current and former employees (and their dependants) who are eligible for benefits. Demographic assumptions deal with matters such as:

   i. mortality, both during and after employment;
   ii. rates of employee turnover, disability and early retirement;
   iii. the proportion of plan members with dependants who will be eligible for benefits;
   iv. claim rates under medical plans; and

b. financial assumptions, dealing with items such as:

   i. the discount rate
   ii. future salary and benefit levels
   iii. in the case of medical benefits, future medical costs, including, where material, the cost of administering claims and benefit payments and
   iv. the expected rate of return on plan assets.

Financial assumptions: Financial assumptions should be based on market expectation at the balance sheet date for the period over which the post-employment benefit obligations will be settled. Discount rates and other financial assumptions should not be inflation-adjusted unless such measures are more reliable (eg where benefits are index-linked)

11. Actuarial Gains and Losses

Actuarial gains and losses comprise:

- experience adjustments (the effects of difference between the previous actuarial assumptions and what has actually occurred); and

- the effects of changes in actuarial assumptions.

Actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense. While this is the general principle, as per AS 15, in case an enterprise adopts the option to defer the recognition of any subsequent actuarial gains is limited to excess of cumulative (unrecognized gains) over the unrecognized portion of increase in transitional liability.

Illustration 1

Omega Limited belongs to the engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of Rs. 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to Rs. 2 lakhs instead of Rs. 5 lakhs. The average remaining life of the employees is estimated to be 6 years. You are required to advise the company on the following items from the viewpoint of

finalisation of accounts, taking note of the mandatory accounting standards.

Solution

According to AS 15 (Revised 2005) 'Employee Benefits', actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense. Therefore, surplus amount of Rs. 6 lakhs is required to be credited to the profit and loss statement of the current year.

Illustration 2

As on 1st April, 2011 the fair value of plan assets was Rs. 1,00,000 in respect of a pension plan of Zeleous Ltd. On 30th September, 2011 the plan paid out benefits of Rs. 19,000 and received inward contributions of Rs. 49,000. On 31st March, 2012 the fair value of plan assets was Rs. 1,50,000 and present value of the defined benefit obligation was Rs. 1,47,920. Acturial losses on the obligations for the year 2011-12 were Rs. 600.

On 1st April, 2011 the company made the following estimates, based on its market studies, understanding and prevailing prices.

	%
Interest & dividend income, after tax payable by the fund	9.25
Realised and unrealised gains on plan assets (after tax)	2.00
Fund administrative costs	(1.00)
Expected Rate of Return	10.25

You are required to find the expected and actual returns on plan assets.

Answer

Computation of Expected and Actual Returns on Plan Assets

		Rs.
Return on Rs. 1,00,000 held for 12 months at 10.25%		10,250
Return on Rs. 30,000 (49,000-19,000) held for six months at 5%		
(equivalent to 10.25% annually, compounded every six months)		1,500
Expected return on plan assets for 2011-12		11,750
Fair value of plan assets as on 31 March, 2012		1,50,000
Less: Fair value of plan assets as on 1 April,2011	1,00,000	
Contributions received	49,000	(1,49,000)
		1,000
Add: Benefits paid		19,000
Actual return on plan assets		20,000

AS 16: Borrowing Cost

1. Introduction

The standard prescribes the accounting treatment for borrowing costs (i.e. interest and other costs) incurred by an enterprise in connection with the borrowing of funds. Borrowing costs are required to be capitalized as part of a qualifying asset (an asset that takes a substantial period of time to get ready for its intended use), if it is directly attributable towards its acquisition, construction or production. Upon such capitalization, the carrying amount of assets should be assessed as to whether it is greater than its recoverable amount or net realizable value and adjustments are required to be made in accordance with other standards. The amount of borrowing costs eligible for capitalization should be determined in accordance with AS 16 and other borrowing costs (not eligible for capitalization) should be recognized as expenses in the period in which they are incurred.

2. Borrowing Costs

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

a. Interest and commitment charges on bank borrowings and other short-term and long-term borrowings;

b. Amortisation of any discounts or premiums relating to borrowings;

c. Amortisation of ancillary costs incurred in connection with the arrangement of borrowings;

d. Finance charges in respect of assets acquired under finance leases or under other similar arrangements; and

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

An enterprise should not apply AS 16 to borrowing costs directly attributable to the acquisition, construction or production of inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis over a short period of time, since such inventories are not qualifying assets.

3. A Qualifying Asset

A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Borrowing costs are capitalised as part of the cost of a qualifying asset when it is probable that they will result in future economic benefits to the enterprise and the costs can be measured reliably. Other borrowing costs are recognised as an expense in the period in which they are incurred.

The issue as to what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, 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 facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale should be

considered.

Depending on the circumstances, any of the following may be qualifying assets.

- inventories that take a substantial amount of time to bring them to a saleable condition For example, liquor is often required to be kept in store for more than twelve months for maturing.;
- investments properties;
- manufacturing plants; and
- power generation facilities.

The following are not qualifying assets:
- assets that are ready for their intended use or sale when acquired; and
- inventories that are routinely manufactured, or otherwise produced in large quantities on a repetitive basis, over a short period or time.

4. Borrowing Costs Eligible for Capitalisation

The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made.

When an enterprise borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that directly relate to that qualifying asset can be readily identified. It may be difficult to identify a direct relationship between particular borrowings and a qualifying asset and to determine the borrowings that could otherwise have been avoided. To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be 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.

The financing arrangements for a qualifying asset may result in an enterprise obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for expenditure on the qualifying asset. In such circumstances, the funds are often temporarily invested pending their expenditure on the qualifying asset. In determining the amount of borrowing costs eligible for capitalisation during a period, any income earned on the temporary investment of those borrowings is deducted from the borrowing costs incurred.

Exchange differences on the amount of principal of the foreign currency borrowings to the extent of difference between interest on local currency borrowings and interest on foreign currency borrowings. For this purpose, the interest rate for the local currency borrowings should be considered as that rate at which the enterprise would have raised the borrowings locally had the enterprise not decided to raise the foreign currency borrowings. If the difference between the interest on local currency borrowings and the interest on foreign currency borrowings is equal to or more than the exchange difference on the amount of principal of the foreign currency borrowings, the entire amount of exchange difference is covered.

5. 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, the 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.

6. Commencement of Capitalisation

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

a. Expenditure for the acquisition, construction or production of a qualifying asset is being incurred: Expenditure on a qualifying asset includes only such expenditure that has resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditure is reduced by any progress payments received and grants received in connection with the asset. The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditure to which the capitalisation rate is applied in that period.

b. Borrowing costs are being incurred.

c. Activities that are necessary to prepare the asset for its intended use or sale are in progress: The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset. They include technical and administrative work prior to the commencement of physical construction. However, such activities exclude the holding of an asset when no production or development that changes the asset's condition is taking place.

7. Suspension Of Capitalisation

Capitalisation of borrowing costs should generally continue as long as the three conditions listed above are met. If, however, the enterprise suspends activities related to development for an extended period, capitalisation of borrowing costs should also cease unit such time as activities are resumed.

However, capitalisation of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Capitalisation of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

8. Cessation of Capitalisation

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

9. Disclosure

The financial statements should disclose:

a. The accounting policy adopted for borrowing costs; and

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

10. Illustrations

Illustration 1

Particulars	Amount (Rs.)
Expenditure incurred till 31-03-2011	7,00,000
Interest cost capitalized for the financial year 2010-11	30,000
Amount borrowed till 31-03-11	4,00,000
Amount transferred to construction during 2011-12	2,00,000
Cash payment during 2011-12	1,00,000
Progress payment received	5,00,000
New borrowing during 2011-12 @ 15%	3,00,000

Calculate the amount of borrowing to be capitalized.

Solution

Total Borrowing Cost = 7,00,000 X 0.15 = Rs. 1,05,000

Particulars	Amount (Rs.)
Expenditure incurred including previously capitalized borrowing cost	7,30,000
Cash payment during 2011-12	1,00,000
Asset transferred during 2011-12	1,00,000
	9,30,000
	5,00,000
Less: Progress payment received	4,30,000

Money borrowed including previously capitalized interest cost = Rs. 7,30,000

Borrowing cost to be capitalized = 4,30,000/7,30,000x1,05,000 = Rs. 61,849.32

Illustration 2

PRM Ltd. obtained a loan from a bank for Rs. 50 lakhs on 30-04-2011. It was utilized as follows:

Particulars	Amount (Rs. in lakhs)
Construction of a shed	50
Purchase of a machinery	40
Working Capital	20
Advance for purchase of truck	10

Construction of shed was completed in March 2012. The machinery was installed on the same date. Delivery truck was not received. Total interest charged by the bank for the year ending 31-03-2012 was Rs. 18 lakhs. Show the treatment of interest.

Solution

Qualifying Asset as per AS-16 = Rs. 50 lakhs (construction of a shed)

Borrowing cost to be capitalized = 18X 50/120 =Rs. 7.5 lakhs

Interest to be debited to Profit or Loss account = Rs. (18 – 7.5) lakhs
= Rs. 10.5 lakhs

Illustration 3

The notes to accounts of X Ltd. for the year 2011-2012 include the following:

"Interest on bridge loan from banks and Financial Institutions and on Debentures specifically obtained for the Company's Fertiliser Project amounting to Rs. 1,80,80,000 has been capitalized during the year, which includes approximately Rs. 1,70,33,465 capitalised in respect of the utilization of loan and debenture money for the said purpose." Is the treatment correct? Briefly comment.

Solution

The treatment done by the company is not in accordance with AS 16 'Borrowing Costs'. As per para 10 of AS 16, to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period. Hence, the capitalisation of borrowing costs should be restricted to the actual amount of interest expenditure i.e. Rs. 1,70,33,465. Thus, there is an excess capitalisation of Rs. 10,46,535. This has resulted in overstatement of profits by Rs. 10,46,535 and amount of fixed assets has also gone up by this amount.

Illustration 4

XYZ Ltd., has undertaken a project for expansion of capacity as per the following details:

	Plan Rs.	Actual Rs.
April, 2012	2,00,000	2,00,000
May, 2012	2,00,000	3,00,000
June, 2012	10,00,000	–
July, 2012	1,00,000	–
August, 2012	2,00,000	1,00,000
September, 2012	5,00,000	7,00,000

The company pays to its bankers at the rate of 12% p.a., interest being debited on a monthly basis. During the half year company had Rs. 10 lakhs overdraft upto 31st July, surplus cash in August and again overdraft of over Rs. 10 lakhs from 1.9.2012. The company had a strike during June and hence could not continue the work during June. Work was again commenced on 1st July and all the works were completed on 30th September. Assume that expenditure was incurred on 1st day of each month. Calculate:

i. Interest to be capitalised.
ii. Give reasons wherever necessary.

Assume:

a. Overdraft will be less, if there is no capital expenditure.
b. The Board of Directors based on facts and circumstances of the case has decided that any capital expenditure taking more than 3 months as substantial period of time.

Solution

a. XYZ Ltd.

Month	Actual Expenditure Rs.	Interest Capitalised Rs.	Cumulative Amount Rs.	
April, 2012	2,00,000	2,000	2,02,000	
May, 2012	3,00,000	5,020	5,07,020	
June, 2012	–	5,070	5,12,090	Note 2
July, 2012	–	5,120	5,17,210	
August, 2012	1,00,000	–	6,17,210	Note 3
September, 2012	7,00,000	10,000	13,27,210	Note 4
	13,00,000	27,210	13,27,210	

Note:

1. There would not have been overdraft, if there is no capital expenditure. Hence, it is a case of specific borrowing as per AS 16 on Borrowing Costs.

2. The company had a strike in June and hence could not continue the work during June. As per para 14 (c) of AS 16, the activities that are necessary to prepare the asset for its intended use or sale are in progress. The strike is not during extended period. Thus during strike period, interest need to be capitalised.

3. During August, the company did not incur any interest as there was surplus cash in August. Therefore, no amount should be capitalised during August as per para 14(b) of AS 16.

4. During September, it has been taken that actual overdraft is Rs. 10 lakhs only. Hence, only Rs. 10,000 interest has been capitalised even though actual expenditure exceeds Rs. 10 lakhs.

   Alternatively, interest may be charged on total amount of (Rs. 6,17,210 + Rs. 7,00,000 = 13,17,210) for the month of September, 2012 as it is given in the question that overdraft was over Rs. 10 lakhs from 1.9.2012 and not exactly Rs. 10 lakhs. In that case, interest amount Rs. 13,172 will be capitalised for the month of September.

AS 17: Segment Reporting

1. Introduction

This standard establishes principles for reporting financial information about different types of products and services an enterprise produces and different geographical areas in which it operates. The information is expected to help users of financial statements, to better understand the performance and assess the risks and returns of the enterprise and make more informed judgements about the enterprise as a whole. The standard is more relevant for assessing risks and returns of a diversified or multilocational enterprise which may not be determinable from the aggregated data.

2. Objective

Many enterprises provide groups of products and services or operate in geographical areas that are subject to differing rates of profitability, opportunities for growth, future prospects, and risks. The objective of this Statement 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. Such information helps users of financial statements:

a. Better understand the performance of the enterprise;
b. Better assess the risks and returns of the enterprise; and
c. Make more informed judgements about the enterprise as a whole.

3. Scope

An enterprise should comply with the requirements of this Statement fully and not selectively. 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. In the context of reporting

of segment information in consolidated financial statements, the references in this Statement to any financial statement items should construed to be the relevant item as appearing in the consolidated financial statements.

4. Definition of the Terms Used in the Accounting Standard

A business segment is 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 that should be considered in determining whether products or services are related include:

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

A single business segment does not include products and services with significantly differing risks and returns. While there may be dissimilarities with respect to one or several of the factors listed in the definition of business segment, the products and services included in a single business segment are expected to be similar with respect to a majority of the factors.

A geographical segment is 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 that should be considered in identifying geographical segments include:

a. Similarity of economic and political conditions.
b. Relationships between operations in different geographical areas.
c. Proximity of operations.
d. Special risks associated with operations in a particular area.
e. Exchange control regulations and
f. The underlying currency risks.

A single geographical segment does not include operations in economic environments with significantly differing risks and returns. A geographical segment may be a single country, a group of two or more countries, or a region within a country.

The risks and returns of an enterprise are influenced both by the geographical location of its operations and also by the location of its customers. The definition allows geographical segments to be based on either:

a. The location of production or service facilities and other assets of an enterprise; or
b. The location of its customers.

A reportable segment is a business segment or a geographical segment identified on the basis of foregoing

definitions for which segment information is required to be disclosed by this Statement.

The predominant sources of risks affect how most enterprises are organised and managed. Therefore, the organisational structure of an enterprise and its internal financial reporting system are normally the basis for identifying its segments.

Segment revenue is the aggregate of

i. The portion of enterprise revenue that is directly attributable to a segment,
ii. The relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, and
iii. Revenue from transactions with other segments of the enterprise.

Segment revenue does not include:

a. Extraordinary items as defined in AS 5.

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

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

Segment expense is the aggregate of

i. The expense resulting from the operating activities of a segment that is directly attributable to the segment, and
ii. The relevant portion of enterprise expense that can be allocated on a reasonable basis to the segment,
iii. Including expense relating to transactions with other segments of the enterprise.

Segment expense does not include:

a. Extraordinary items as defined in AS 5.

b. Interest expense, including interest incurred on advances or loans from other segments, unless the operations of the segment are primarily of a financial nature.

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

d. Income tax expense; and

e. General administrative expenses, head-office expenses, and other expenses that arise at the enterprise level and relate to the enterprise as a whole. However, costs are sometimes incurred at the enterprise level on behalf of a segment. Such costs are part of segment expense if they relate to the operating activities of the segment and if they can be directly attributed or allocated to the segment on a reasonable basis.

Segment assets are those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.

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

Segment assets do not include:

- 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.

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

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

Liabilities that relate jointly to two or more segment should be allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments.

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

Segment liabilities do not include:

- income tax liabilities;
- borrowings and other liabilities that are incurred for financing rather than operating purposes.

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

In case interest is included as a part of the cost of inventories where it is so required as per AS 16, read with AS 2, Valuation of Inventories, and those inventories are part of segment assets of a particular segment, such interest should be considered as a segment expense. In this case, the amount of such interest and the fact that the segment result has been arrived at after considering such interest should be disclosed by way of a note to the segment result.

5. Allocation

An enterprise looks to its internal financial reporting system as the starting point for identifying those items that can be directly attributed, or reasonably allocated, to segments. There is thus a presumption that amounts that have been identified with segments for internal financial reporting purposes are directly attributable or reasonably allocable to segments for the purpose of measuring the segment revenue, segment expense, segment assets, and segment liabilities of reportable segments.

In some cases, however, a revenue, expense, asset or liability may have been allocated to segments for internal

financial reporting purposes on a basis that is understood by enterprise management but that could be deemed arbitrary in the perception of external users of financial statements. Conversely, an enterprise may choose not to allocate some item of revenue, expense, asset or liability for internal financial reporting purposes, even though a reasonable basis for doing so exists. Such an item is allocated pursuant to the definitions of segment revenue, segment expense, segment assets, and segment liabilities in this Statement. Segment revenue, segment expense, segment assets and segment liabilities are determined before intra-enterprise balances and intra-enterprise transactions are eliminated as part of the process of preparation of enterprise financial statements, except to the extent that such intra-enterprise balances and transactions are within a single segment. While the accounting policies used in preparing and presenting the financial statements of the enterprise as a whole are also the fundamental segment accounting policies, segment accounting policies include, in addition, policies that relate specifically to segment reporting, such as identification of segments, method of pricing inter-segment transfers, and basis for allocating revenues and expenses to segments.

6. Primary and Secondary Segment Reporting Formats

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 and, therefore, for determining which reporting format is primary and which is secondary, except as provided paragraphs below:

a. If risks and returns of an enterprise are strongly affected both by differences in the products and services it produces and by differences in the geographical areas in which it operates, as evidenced by a 'matrix approach', then the enterprise should use business segments as its primary segment reporting format and geographical segments as its secondary reporting forma; and

b. If internal organisational and management structure of an enterprise are based neither on individual products or services or groups of related products/services nor on geographical areas, it should be determined whether the risks and returns of the enterprise are related more to the products and services it produces or to the geographical areas in which it operates and accordingly, choose segments.

7. Matrix Presentation

A 'matrix presentation' both business segments and geographical segments as primary segment reporting formats with full segment disclosures on each basis will often provide useful information if risks and returns of an enterprise are strongly affected both by differences in the products and services it produces and by differences in the geographical areas in which it operates. This Statement does not require, but does not prohibit, a 'matrix presentation'.

8. Business and Geographical Segments

Generally Business and Geographical segments are determined on the basis of internal financial reporting to the board of directors and the chief executive officer. But if such segment does not satisfy the definitions given in AS, then following points should be considered for:

a. If one or more of the segments reported internally to the directors and management is a business segment or a geographical segment based on the factors in the definitions but others are not, paragraph below should be applied only to those internal segments that do not meet the definitions.

b. For those segments reported internally to the directors and management that do not satisfy the definitions, management of the enterprise should look to the next lower level of internal segmentation that reports information along product and service lines or geographical lines, as appropriate under the definitions and

c. If such an internally reported lower-level segment meets the definition of business segment or geographical segment, the criteria for identifying reportable segments should be applied to that segment.

9. Identifying Reportable Segments (Quantitative Thresholds)

A business segment or geographical segment should be identified as a reportable segment if:

a. Its revenue from sales to external customers and from transactions with other segments is 10 per cent or more of the total revenue, external and internal, of all segments; or

b. Its segment result, whether profit or loss, is 10 per cent or more of -
   i. The combined result of all segments in profit, or
   ii. The combined result of all segments in loss,
   iii. Whichever is greater in absolute amount; or

c. Its segment assets are 10 per cent or more of the total assets of all segments.

A business segment or a geographical segment which is not a reportable segment as per above paragraph, may be designated as a reportable segment despite its size at the discretion of the management of the enterprise. If that segment is not designated as a reportable segment, it should be included as an unallocated reconciling item.

If total external revenue attributable to reportable segments constitutes less than 75 per cent of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10 per cent thresholds, until at least 75 per cent of total enterprise revenue is included in reportable segments.

A segment identified as a reportable segment in the immediately preceding period because it satisfied the relevant 10 per cent thresholds should continue to be a reportable segment for the current period notwithstanding that its revenue, result, and assets all no longer meet the 10 percent thresholds.

If a segment is identified as a reportable segment in the current period because it satisfies the relevant 10 per cent thresholds, preceding-period segment data that is presented for comparative purposes should, unless it is impracticable to do so, be restated to reflect the newly reportable segment as a separate segment, even if that segment did not satisfy the 10 per cent thresholds in the preceding period.

10. Segment Accounting Policies

Segment information should be prepared in conformity with the accounting policies adopted for preparing and

presenting the financial statements of the enterprise as a whole. This Statement does not prohibit the disclosure of additional segment information that is prepared on a basis other than the accounting policies adopted for the enterprise financial statements provided that (a) the information is reported internally to the board of directors and the chief executive officer for purposes of making decisions about allocating resources to the segment and assessing its performance and (b) the basis of measurement for this additional information is clearly described. 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.

11. Primary Reporting Format

An enterprise should disclose the following for each reportable segment:

a. Segment revenue, classified into segment revenue from sales to external customers and segment revenue from transactions with other segments;

b. Segment result;

c. Total carrying amount of segment assets;

d. Total amount of segment liabilities;

e. 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);

f. Total amount of expense included in the segment result for depreciation and amortisation in respect of segment assets for the period; and

g. 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.

An enterprise is encouraged, but not required, to disclose the nature and amount of any items of segment revenue and segment expense that are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the segment for the period. Such disclosure is not intended to change the classification of any such items of revenue or expense from ordinary to extraordinary or to change the measurement of such items. The disclosure, however, does change the level at which the significance of such items is evaluated for disclosure purposes from the enterprise level to the segment level.

AS 3, recommends that an enterprise present a cash flow statement that separately reports cash flows from operating, investing and financing activities. Disclosure of information regarding operating, investing and financing cash flows of each reportable segment is relevant to understanding the enterprise's overall financial position, liquidity, and cash flows. Disclosure of segment cash flow is, therefore, encouraged, though not required. An enterprise that provides segment cash flow disclosures need not disclose depreciation and amortisation expense and non-cash expenses.

An enterprise should present reconciliation between the information disclosed for reportable segments and the

aggregated information in the enterprise financial statements. In presenting the reconciliation, segment revenue should be reconciled to enterprise revenue; segment result should be reconciled to enterprise net profit or loss; segment assets should be reconciled to enterprise assets; and segment liabilities should be reconciled to enterprise liabilities.

12. Secondary Segment Information

If primary format of an enterprise for reporting segment information is business segments, it should also report the following information:

a. 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;

b. 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

c. 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 assets are 10 per cent or more of the total assets of all geographical segments.

If primary format of an enterprise for reporting segment information is geographical segments (whether based on location of assets or location of customers), it should also 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:

a. Segment revenue from external customers;

b. The total carrying amount of segment assets; and

c. 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, then the 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, then the 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:

a. The total carrying amount of segment assets by geographical location of the assets.

b. 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.

13. 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.

Changes in accounting policies adopted for segment reporting that have a material effect on segment information should be disclosed in accordance with AS. 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.

Example could be:
- 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.

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.

Illustration 1

Prepare a segmental report for publication in Diversifiers Ltd. from the following details of the company's three divisions and the head office:

	Rs. ('000)
Forging Shop Division	
Sales to Bright Bar Division	4,575
Other Domestic Sales	90
Export Sales	6,135
	10,800
Bright Bar Division	
Sales to Fitting Division	45

Export Sales to Rwanda	300
	345
Fitting Division	
Export Sales to Maldives	270

Particulars	Head Office Rs. ('000)	Forging Shop Division Rs. ('000)	Bright Bar Division Rs. ('000)	Fitting Division Rs. ('000)
Pre-tax operating result		240	30	(12)
Head office cost reallocated		72	36	36
Interest costs		6	8	2
Fixed assets	75	300	60	180
Net current assets	72	180	60	135
Long-term liabilities	57	30	15	180

Solution

Diversifiers Ltd.
Segmental Report

(Rs. '000)

Particulars	Divisions			Inter Segment Eliminations	Consolidated Total
	Forging shop	Bright Bar	Fitting		
Segment revenue					
Sales:					
Domestic	90	-	-	-	90
Export	6,135	300	270	-	6,705
External Sales	6,225	300	270	-	6,795
Inter-segment sales	4,575	45	-	4,620	-
Total revenue	10,800	345	270	4,620	6,795
Segment result (given)	240	30	(12)		258
Head office expenses			-		(144)
Operating profit					114
Interest expense					(16)

Profit before tax					98
Information in relation to assets and liabilities:					
Fixed assets	300	60	180	-	540
Net current assets	180	60	135	-	375
Segment assets	480	120	315	-	915
Unallocated corporate assets (75 + 72)	-	-	-	-	147
Total assets					1,062
Segment liabilities	30	15	180	-	225
Unallocated corporate liabilities					57
Total liabilities					282

Sales Revenue by Geographical Market

	Home Sales	Export Sales (by forging shop division)	Export to Rwanda	Export to Maldives	(Rs. '000) Consolidated Total
External sales	90	6,135	300	270	6,795

AS 18: Related Party Disclosures

1. Objective

The objective of this Statement is to establish requirements for disclosure of:

a. Related party relationships and
b. Transactions between a reporting enterprise and its related parties.

2. Scope

AS 18 should be applied:

- In reporting related party relationships and transactions between a reporting enterprise and its related parties.
- Only to the related party relationships described in (a) to (e) below.
- To the financial statements of each reporting enterprise as also to consolidated financial statements presented by a holding company.

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

a. Enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are

under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries).

b. Associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture.

c. Individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual.

d. Key management personnel and relatives of such personnel and

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

3. Definitions of the Terms Used in the Accounting Standard

In the context of this Statement, the following are deemed not to be related parties:

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

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

c. The parties listed below, in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of the enterprise or participate in its decision-making process):
   i. Providers of finance.
   ii. Trade unions.
   iii. Public utilities.
   iv. Government departments and government agencies including government sponsored bodies.

Related party disclosure requirements as laid down in this Statement do not apply in circumstances where providing such disclosures would conflict with the reporting enterprise's duties of confidentiality as specifically required in terms of a statute or by any regulator or similar competent authority.

Disclosure of transactions between members of a group is unnecessary in consolidated financial statements because consolidated financial statements present information about the holding and its subsidiaries as a single reporting enterprise. No disclosure is required in the financial statements of state-controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.

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

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

Illustration

Identify the related parties in the following cases as per AS-18
A Ltd. holds 51% of B Ltd.
B Ltd holds 51% of O Ltd.
Z Ltd holds 49% of O Ltd.

Solution

A Ltd., B Ltd. & O Ltd. are related to each other. Z Ltd. & O Ltd. are related to each other by virtue of Associate relationship. However, neither A Ltd. nor B Ltd. is related to Z Ltd. and vice versa.

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.

For the purpose of this Statement, an enterprise is considered to control the composition of the board of directors of a company or governing body of an enterprise, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors/members of that company/enterprise. An enterprise is deemed to have the power to appoint, if any of the following conditions is satisfied:

a. A person cannot be appointed as director/member without the exercise in his favour by that enterprise of such a power as aforesaid or

b. A person's appointment as director/member follows necessarily from his appointment to a position held by him in that enterprise or

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

An enterprise/individual is considered to have a substantial interest in another enterprise if that enterprise or individual owns, directly or indirectly, 20 per cent or more interest in the voting power of the other enterprise.

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.

Significant influence: Participation in the financial and/or operating policy decisions of an enterprise, but not

control of those policies.

It may be exercised in several ways, by representation on the board of directors, participation in the policy making process, material inter-company transactions, interchange of managerial personnel or dependence on technical information.

Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investing party holds, directly or indirectly through intermediaries, 20 per cent or more of the voting power of the enterprise, it is presumed that the investing party does have significant influence, unless it can be clearly demonstrated that this is not the case, vice versa. A substantial or majority ownership by another investing party does not necessarily preclude an investing party from having significant influence.

Key management personnel: Those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.

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.

Joint Venture - a contractual arrangement whereby two or more parties undertake an economic activity which is subject to joint control.

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

Holding Company - a company having one or more subsidiaries.

Subsidiary - a company:

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

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

Fellow subsidiary - a company is considered to be a fellow subsidiary of another company if both are subsidiaries of the same holding company.

4. The Related Party Issue

Without related party disclosures, there is a general presumption that transactions reflected in financial statements are consummated on an arm's-length basis between independent parties. However, that presumption may not be valid when related party relationships exist because related parties may enter into transactions which unrelated parties would not enter into. Also, transactions between related parties may not be effected at the same terms and conditions as between unrelated parties.

The operating results and financial position of an enterprise may be affected by a related party relationship even if related party transactions do not occur. The mere existence of the relationship may be sufficient to affect the transactions of the reporting enterprise with other parties.

In view of the aforesaid, the resulting accounting measures may not represent what they usually would be expected to represent. Thus, a related party relationship could have an effect on the financial position and operating results of the reporting enterprise.

5. Disclosure

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

This is to enable users of financial statements to form a view about the effects of related party relationships on the enterprise.

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

i. The name of the transacting related party;

ii. A description of the relationship between the parties;

iii. A description of the nature of transactions;

iv. Volume of the transactions either as an amount or as an appropriate proportion;

v. Any other elements of the related party transactions necessary for an understanding of the financial statements;

vi. The amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date;

vii. Amounts written off or written back in the period in respect of debts due from or to related parties.

viii. Items of a similar nature may be disclosed in aggregate by type of related party.

6. Miscellaneous Illustrations

Illustration 1

Narmada Ltd. sold goods for Rs. 90 lakhs to Ganga Ltd. during financial year ended 31-3-2012. The Managing Director of Narmada Ltd. own 100% of Ganga Ltd. The sales were made to Ganga Ltd. at normal selling prices followed by Narmada Ltd. The Chief accountant of Narmada Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. Is the Chief Accountant correct?

Solution

As per paragraph 13 of AS 18 'Related Party Disclosures', Enterprises over which a key management personnel is able to exercise significant influence are related parties. This includes enterprises owned by directors or major shareholders of the reporting enterprise that have a member of key management in common with the reporting enterprise.

In the given case, Narmada Ltd. and Ganga Ltd are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price.

Hence the contention of Chief Accountant of Narmada Ltd is wrong.

Illustration 2

Mr. Raj a relative of key Management personnel received remuneration of Rs. 2,50,000 for his services in the company for the period from 1.4.2011 to 30.6.2011. On 1.7.2011 he left the service.

Should the relative be identified as at the closing date i.e. on 31.3.2010 for the purposes of AS 18?

Solution

According to para 10 of AS 18 on Related Party Disclosures, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Hence, Mr. Raj, a relative of key management personnel should be identified as relative as at the closing date i.e. on 31.3.2012.

Illustration 3

X Ltd. sold goods to its associate Company for the 1st quarter ending 30.6.2012. After that, the related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer. Decide whether transactions of the entire year has to be disclosed as related party transaction.

Solution

As per para 23 of AS 18, transactions of X Ltd. with its associate company for the first quarter ending 30.06.2012 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist need not be reported.

AS 19: Leases

1. Introduction

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership.

An operating lease is a lease other than finance lease.

At the inception of the lease, assets under finance lease are capitalized in the books of lessee with corresponding liability for lease obligations as against the operating lease, wherein lease payments are recognized as an expense in profit and loss account on a systematic basis (i.e. straight line) over the lease term without capitalizing the asset. The lessor should recognise receivable at an amount equal to net investment in the lease in case of finance lease,

whereas under operating lease, the lessor will present the leased asset under fixed assets in his balance sheet besides recognizing the lease income on a systematic basis (i.e. straight line) over the lease term. The person (lessor/lessee) presenting the leased asset in his balance sheet should also consider the additional requirements of AS 6 and AS 10.

2. Scope

This Statement is applied in accounting for all leases other than:

a. Lease agreements to explore for or use natural resources, such as oil, gas, timber, metals and other mineral 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.

AS 19 applies to contracts that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. Examples include the supply of property, vehicles and computers.

On the other hand, this Statement does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

The definition of a lease includes agreements for the hire of an asset which contain a provision giving the hirer an option to acquire title to the asset upon the fulfillment of agreed conditions. These agreements are commonly known as hire purchase agreements. Hire purchase agreements include agreements under which the property in the asset is to pass to the hirer on the payment of the last instalment and the hirer has a right to terminate the agreement at any time before the property so passes.

3. Definition of The Terms Used Under As 19

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

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

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

A non-cancellable lease is a lease that is cancellable only:

a. Upon the occurrence of some remote contingency or
b. With the permission of the lessor or
c. If the lessee enters into a new lease for the same or an equivalent asset with the same lessor;
d. Upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

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

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

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.

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

Mr. X took mine on lease from Mr. Y on the terms that he would pay Rs. 10,000 or Rs. 10 per ton extracted during the year, which ever is less. Rs. 10 per ton been contingent cannot be included in minimum lease payment calculation.

Economic life is either:

a. The period over which an asset is expected to be economically usable by one or more users;

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

Useful life of a leased asset is either:

a. The period over which the leased asset is expected to be used by the lessee or

b. The number of production or similar units expected to be obtained from the use of the asset by the lessee.

Residual value of a leased asset is the estimated fair value of the asset at the end of the lease term.

Guaranteed residual value is:

a. In the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party on behalf of the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable) and

b. In the case of the lessor, that part of the residual value which is guaranteed by or on behalf of the lessee, or by an independent third party who is financially capable of discharging the obligations under the guarantee.

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

We can say that:
Residual Value of the Assets = Guaranteed Residual Value + Unguaranteed Residual Value

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.

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.

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

The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of

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

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.

Contingent rent is that portion of the lease payments that is not fixed in amount but is based on a factor other than just the passage of time (e.g., percentage of sales, amount of usage, price indices and market rates of interest).

4. Classification of Leases

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. Title may or may not eventually be transferred. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership.

Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than its form. Examples of situations which would normally lead to a lease being classified as a finance lease are:

a. The lease transfers ownership of the asset to the lessee by the end of the lease term.

b. The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised.

c. The lease term is for the major part of the economic life of the asset even if title is not transferred.

d. At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset and

e. The leased asset is of a specialised nature such that only the lessee can use it without major modifications being made.

Other indicators that, individually or in combination, could also lead to a lease being classified as a finance lease are:

a. If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee.

b. Gains or losses from the fluctuation in the fair value of the residual fall to the lessee and

c. The lessee can continue the lease for a secondary period at a rent which is substantially lower than market rent.

Lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease after inception, other than by renewing the lease, in a manner that would have resulted in a different classification, had the changed terms been in effect at the inception of the lease, the revised agreement is considered as a new agreement over its revised term. Changes in estimates or changes in circumstances, however, do not give rise to a new classification of a lease for accounting purposes.

5. Leases in the Financial Statements of Lessees

5.1 Finance Leases: (1) Both the leased asset and the related lease obligation (liability) should be recorded in the balance sheet.

At the inception of a finance lease,

Such recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee. In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used.

In the case of finance leases the substance and financial reality are that the lessee acquires the economic benefits of the use of the leased asset for the major part of its economic life in return for entering into an obligation to pay for that right an amount approximating to the fair value of the asset and the related finance charge.

Initial direct costs are often incurred in connection with specific leasing activities, eg. in negotiating and securing leasing arrangements. The costs identified as directly attributable to activities performed by the lessee for a finance lease are included as part of the amount recognised as an asset under the finance lease to the extent that they can be directly attributed to the activities performed by the lessee for a finance lease.

Lease payments should be apportioned between the finance charge and the reduction of the outstanding liability.

The finance charge should be allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

The depreciable amount of a leased asset is allocated to each accounting period during the period of expected use on a systematic basis consistent with the depreciation policy the lessee adopts for depreciable assets that are owned. If there is reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the asset is depreciated over the lease term or its useful life, whichever is shorter.

5.2 Operating Leases: Rentals payable under an operating lease should be charged as an expense in the statement of profit and loss on a straight-line basis over the lease term, even if the payments are not made on that basis, unless another systematic basis is more representative of the time pattern of the user's benefit. For example, where the rental payments for an asset are based on the actual usage of that asset, or are revised periodically to reflect the efficiency of the asset or current market rates, the rentals actually payable may be an appropriate measure.

5.3 Disclosure Requirements for Lessees: Lessees are required to make the following disclosures for finance leases:

- Assets acquired under finance lease as segregated from assets owned;
- For each class of assets, the net carrying amount at the balance sheet date;
- A reconciliation between the total of future minimum lease payments at the balance sheet date, and their present value; (SMC are exempt from this disclosure requirement)
- The total of future minimum lease payments at the balance sheet date, and their present value, for each of the following periods:
  - Not later than one year;
  - Later than one year and not later than five years; and
  - Later than five years;

(SMCs are exempt from this disclosure requirement)

- Contingent rents recognized as an expense in the period;
- The total of future minimum sublease payments expected to be received under non-cancellable sub-leases at the balance sheet date (SMCs are exempt from this disclosure requirement); and
- A general description of the lessee's material leasing arrangements including, but not limited to, the following:
  - The basis on which contingent rents 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.

(SMCs are exempt from this disclosure requirement)

Note that in addition to the above the disclosure requirements of AS 6 and AS10 apply equally to assets held under finance leases.

Operating leases:

a. The total of future minimum lease payments under non-cancellable operating leases for each of the following periods:
   I. Not later than one year;
   ii. Later than one year and not later than five years;
   iii. Later than five years;

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

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

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

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

6. Leases in the Financial Statements Of Lessors

6.1 Finance Lease: The lessor should recognise assets given under a finance lease in its balance sheet as a receivable and sales in the statement of profit and loss for the period, in accordance with the policy followed by the enterprise for outright sales. The transaction is recorded at the commencement of a finance lease term by a manufacturer or dealer lessor is the fair value of the asset. However, if the present value of the minimum lease payments accruing to the lessor computed at a commercial rate of interest is lower than the fair value, the amount recorded is the present value so computed. The difference between the sales revenue and the cost of sale is the selling profit, which is recognised in accordance with the policy followed by the enterprise for sales.

Manufacturers or dealers may offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to two types of income:

a. The profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts;

b. The finance income over the lease term.
   Lease payments relating to the accounting period, excluding costs for services, are reduced from both the

principal and the unearned finance income. Estimated unguaranteed residual values used in computing the lessor's gross investment in a lease are reviewed regularly. If there has been a reduction in the estimated unguaranteed residual value, the income allocation over the remaining lease term is revised and any reduction in respect of amounts already accrued is recognised immediately. An upward adjustment of the estimated residual value is not made.

Manufacturer or dealer lessors sometimes quote artificially low rates of interest in order to attract customers. The use of such a rate would result in an excessive portion of the total income from the transaction being recognised at the time of sale. If artificially low rates of interest are quoted, selling profit would be restricted to that which would apply if a commercial rate of interest were charged and balance will be adjusted with the finance income over the lease term.

Initial direct costs, such as commissions and legal fees, are often incurred by lessors in negotiating and arranging a lease. For finance leases, these initial direct costs are incurred to produce finance income and are either recognised immediately in the statement of profit and loss or allocated against the finance income over the lease term.

6.2 Disclosure: The lessor should make the following disclosures for finance leases:

a. Reconciliation between the total gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date. In addition, an enterprise should disclose the total gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date, for each of the following periods:
   i. Not later than one year;
   ii Later than one year and not later than five years;
   iii. Later than five years;

b. Unearned finance income;

c. The unguaranteed residual values accruing to the benefit of the lessor;

d. The accumulated provision for uncollectible minimum lease payments receivable;

e. Contingent rents recognised in the statement of profit and loss for the period;

f. A general description of the significant leasing arrangements of the lessor; and

g. Accounting policy adopted in respect of initial direct costs.

Illustration 1 (finance lease)

'A' leased a machine from 'B' on the following terms:

a. The ownership of the machine will be transferred to 'A' on expiry of the lease period at Rs. 8,900.
b. Installation cost of the machine Rs. 5,000.
c. The cost of the machine is Rs. 1,09,240.
d. Lease agreement is signed for 5 years.

e. Minimum Lease Payment is Rs. 28,000 p.a.
f. First installment is Payable on 01.04.2012.
g. Depreciation is charged @ 25% p.a. on WDV.

You are required to show the complete chart of principle amount and implicit rate of interest for 5 years and also the journal entries in the books of 'A and B' for the period 01.04.2012 to 31.03.2017.

Solution

First for the student is to calculate the implicit rate of return, i.e. the rate of Present Value at which the PV of Minimum Lease Payment equals to Market Price of the Assets on the date of lease agreement.

Lease Payment	Present Value Factor 12%	Present Value of Lease Payment	Present Value Factor @ 14%	Present Value of Lease Payment
28,000	1	28,000	1	28,000
28,000	0.893	25,000	0.877	24,561
28,000	0.797	22,321	0.769	21,545
28,000	0.712	19,930	0.675	18,899
28,000	0.636	17,795	0.592	16,578
8,900	0.567	5,050	0.519	4,622
		118,096		114,206

Installment	Opening Balance	Interest Amount	Principle Amount	Closing Balance
1	114,240	-	28,000	86,240
2	86,240	12,074	15,926	70,314
3	70,314	9,844	18,156	52,158
4	52,158	7,302	20,698	31,460
5	31,460	4,404	23,596	7,864
	7,864	1,036	7,864	(0)

Journal Entries

In the Books of Mr. A				In the Books of Mr. B		
Date	Particulars	Dr.	Cr.	Particulars	Dr.	Cr.
Purchase of Machine on Lease:						
2012						
01-Apr	Machine on Lease A/c Dr.	114,240		Mr. A A/c Dr.	109,240	
	To Mr. B A/c		109,240	To Lease Sales A/c		109,240
	To Bank A/c		5,000			
Payment of First Installment:						
	Mr. B A/c Dr.	28,000		Bank A/c Dr.	28,000	
	To Bank A/c		28,000	To Mr. A A/c		28,000
Interest due for the First Year @ 14% p.a.:						
2013						
31-Mar	Interest A/c Dr.	12,074		Mr. A A/c Dr.	12,074	
	To Mr. B A/c		12,074	To Interest A/c		12,074
Charging Depreciation:						
	Depreciation A/c Dr.	28,560				
	To Machine A/c		28,560			
Transfer to Profit & Loss Account:						
	Profit & Loss A/c Dr.	40,634		Interest A/c Dr.	12,074	
	To Interest A/c		12,074	To Profit & Loss A/c		12,074
	To Depreciation A/c		28,560			
Payment of Second Installment:						
01-Apr	Mr. B A/c Dr.	28,000		Bank A/c	Dr.28,000	
	To Bank A/c		28,000	To Mr. A A/c		28,000
Interest due for the Second Year @ 14% p.a.:						
2014						
31-Mar	Interest A/c Dr.	9,844		Mr. A A/c	Dr.9,844	
	To Mr. B A/c		9,844	To Interest A/c		9,844
Charging Depreciation:						
	Depreciation A/c Dr.	21,420				
	To Machine A/c		21,420			

Transfer to Profit & Loss Account:					
Profit & Loss A/c Dr.	31,264		Interest A/c Dr.	9,844	
To Interest A/c 9,844			To Profit & Loss A/c		9,844
To Depreciation A/c		21,420			
Payment of Third Installment:					
01-Apr Mr. B A/c Dr.	28,000		Bank A/c Dr.	28,000	
To Bank A/c		28,000	To Mr. A A/c		28,000
Interest due for the Third Year @ 14% p.a.:					
2015					
31-Mar Interest A/c Dr.	7,302		Mr. A A/c Dr.	7,302	
To Mr. B A/c		7,302	To Interest A/c		7,302
Charging Depreciation:					
Depreciation A/c Dr.	16,065				
To Machine A/c		16,065			
Transfer to Profit & Loss Account:					
Profit & Loss A/c Dr.	23,367				
To Interest A/c		7,302	Interest A/c Dr.	7,302	
To Depreciation A/c		16,065	To Profit & Loss A/c		7,302
Payment of Fourth Installment:					
01-Apr Mr. B A/c Dr.	28,000		Bank A/c Dr.	28,000	
To Bank A/c		28,000	To Mr. A A/c		28,000
Interest due for the Fourth Year @ 14% p.a.:					
2016					
31-Mar Interest A/c Dr.	4,404		Mr. A A/c Dr.	4,404	
To Mr. B A/c		4,404	To Interest A/c		4,404
Charging Depreciation:					
Depreciation A/c Dr.	12,049				
To Machine A/c		12,049			
Transfer to Profit & Loss Account:					
Profit & Loss A/c Dr.	16,453		Interest A/c Dr.	4,404	
To Interest A/c		4,404	To Profit & Loss A/c		4,404
To Depreciation A/c		12,049			

Payment of Fifth Installment:					
01-Apr Mr. B A/c Dr.	28,000		Bank A/c Dr.	28,000	
To Bank A/c		28,000	To Mr. A A/c		28,000
Interest due for the Last Year @ 14% p.a.:					
2017					
31-Mar Interest A/c Dr.	1,036		Mr. A A/c Dr.	1,036	
To Mr. B A/c		1,036	To Interest A/c		1,036
Charging Depreciation:					
Depreciation A/c Dr.	9,037				
To Machine A/c		9,037			
Transfer to Profit & Loss Account:					
Profit & Loss A/c Dr.	10,073		Interest A/c Dr.	1,036	
To Interest A/c		1,036	To Profit & Loss A/c		1,036
To Depreciation A/c		9,037			
Purchase of Asset on expiry of Lease Term:					
Mr. B A/c Dr.	8,900		Bank A/c Dr.	8,900	
To Bank A/c		8,900	To Mr. A A/c		8,900

6.3 Operating Leases: The lessor should present an asset given under operating lease in its balance sheet under fixed assets.

Lease income should be recognised in the statement of profit and loss on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which benefit derived from the use of the leased asset is diminished. Costs, including depreciation, incurred in earning the lease income are recognised as an expense. Initial direct costs incurred are either deferred and allocated to income over the lease term in proportion to the recognition of rent income, or are recognised as an expense in the statement of profit and loss in the period in which they are incurred. For charging depreciation and impairment of assets, relevant Accounting Standards should be followed.

6.4 Disclosures

a. For each class of assets, the gross carrying amount, the accumulated depreciation and accumulated impairment losses at the balance sheet date; and
   i. The depreciation recognised in the statement of profit and loss for the period;
   ii. Impairment losses recognised in the statement of profit and loss for the period;
   iii. Impairment losses reversed in the statement of profit and loss for the period;

b. The future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods:
   i. Not later than one year;
   ii. Later than one year and not later than five years;
   iii. Later than five years;

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

d. A general description of the lessor's significant leasing arrangements; and

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

Illustration 2 (operating lease)

Geeta purchased a computer for Rs. 44,000 and leased out it to Sita for four years on leases basis, after the lease period, value of the computer was estimated to be Rs. 3,000; which she realised after selling it in the second hand market. Lease amount payable at the beginning of each year is Rs. 22,000; Rs. 13,640; Rs. 6,820 & Rs. 3,410. Depreciation was charged @ 40% p.a. You are required to pass the necessary journal entries in the books of both Geeta and Sita.

Solution

In the Books of Geeta				In the Books of Sita		
Date	**Particulars**	**Dr.**	**Cr.**	**Particulars**	**Dr.**	**Cr.**
Purchase of computers:						
1st	Computer A/c. Dr.	44,000				
	To Bank A/c		44,000			
Payment of first year's lease:						
	Bank A/c. Dr.	22,000		Lease Rent Paid A/c. Dr.	22,000	
	To Lease Rent A/c.		22,000	To Bank A/c.		22,000
Depreciation for first year:						
	Depreciation A/c Dr.	17,600				
	To Machine A/c		17,600			
Transfer to profit & loss account:						
	Profit & Loss A/c Dr.	17,600		Profit & Loss A/c. Dr.	22,000	
	To Depreciation A/c		17,600	To Lease Rent Paid A/c.		22,000
	Lease Rent A/c. Dr.	22,000				
	To Profit & Loss A/c.		22,000			
Payment of second year's lease:						
2nd	Bank A/c. Dr.	13,640		Lease Rent Paid A/c. Dr.	13,640	
	To Lease Rent A/c.		13,640	To Bank A/c.		13,640
Depreciation for second year:						
	Depreciation A/c Dr.	10,560				
	To Machine A/c		10,560			
Transfer to profit & loss account:						
	Profit & Loss A/c Dr.	10,560		Profit & Loss A/c. Dr.	13,640	
	To Depreciation A/c		10,560	To Lease Rent Paid A/c.		13,640
	Lease Rent A/c. Dr.	13,640				
	To Profit & Loss A/c.		13,640			
Payment of third year's lease:						
3rd	Bank A/c. Dr.	6,820		Lease Rent Paid A/c. Dr.	6,820	
	To Lease Rent A/c.		6,820	To Bank A/c.		6,820

Depreciation for third year:					
Depreciation A/c Dr.	6,336				
To Machine A/c		6,336			
Transfer to profit & loss account:					
Profit & Loss A/c Dr.	6,336		Profit & Loss A/c. Dr.	6,820	
To Depreciation A/c		6,336	To Lease Rent Paid A/c.		6,820
Lease Rent A/c. Dr.	6,820				
To Profit & Loss A/c.		6,820			
Payment of fourth year's lease:					
4th Bank A/c. Dr.	3,410		Lease Rent Paid A/c. Dr.	3,410	
To Lease Rent A/c.		3,410	To Bank A/c.		3,410
Depreciation for fourth year:					
Depreciation A/c Dr.	3,802				
To Machine A/c		3,802			
Transfer to profit & loss account:					
Profit & Loss A/c Dr.	3,802		Profit & Loss A/c. Dr.	3,410	
To Depreciation A/c		3,802	To Lease Rent Paid A/c.		3,410
Lease Rent A/c. Dr.	3,410				
To Profit & Loss A/c.		3,410			
Sale of lease asset:					
Bank Account Dr.	3,000				
Loss on Sale A/c. Dr.	2,702				
To Computer A/c.		5,702			

7. Sale and Leaseback Transactions

A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor. The lease payments and the sale price are usually interdependent as they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved. If a sale and leaseback transaction results in a finance lease, any excess or deficiency of sales proceeds over the carrying amount should not be immediately recognised as income or loss in the financial statements of a seller-lessee. Instead, it should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognised immediately.

AS 24: Discontinuing Operations

1. Objective

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

2. Discontinuing Operation

A discontinuing operation is a component of an enterprise:

a. That the enterprise, pursuant to a single plan, is:
   i. Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or

   ii. Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or

   iii. Terminating through abandonment and

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

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

A reportable business segment or geographical segment as defined in AS 17 'Segment Reporting', would normally satisfy criterion (b) of the above definition, that is, it would represent a separate major line of business or geographical

area of operations. A part or such a segment may also satisfy criterion (b) of the above definition. For an enterprise that operates in a single business or geographical segment and, therefore, does not report segment information, a major product or service line may also satisfy the criteria of the definition.

The sales of assets and settlements of liabilities may occur over a period of months or perhaps even longer. Thus, disposal of a component may be in progress at the end of a financial reporting period. To qualify as a discontinuing operation, the disposal must be pursuant to a single coordinated plan.

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. However, changing the scope of an operation or the manner in which it is conducted is not abandonment because that operation, although changed, is continuing.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

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

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

c. Shifting of some production or marketing activities for a particular line of business from one location to another and

d. Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

A component can be distinguished operationally and for financial reporting purposes - criterion (c) of the definition of a discontinuing operation - if all the following conditions are met:

a. The operating assets and liabilities of the component can be directly attributed to it.

b. Its revenue can be directly attributed to it.

c. At least a majority of its operating expenses can be directly attributed to it.

Assets, liabilities, revenue, and expenses are directly attributable to a component if they would be eliminated when the component is sold, abandoned or otherwise disposed of. If debt is attributable to a component, the related interest and other financing costs are similarly attributed to it. Discontinuing operations are infrequent events, but this does not mean that all infrequent events are discontinuing operations.

3. Initial Disclosure Event

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

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

b. The enterprise's board of directors or similar governing body has both

c. i. approved a detailed, formal plan for the discontinuance and
   ii. made an announcement of the plan.

A Detailed, Formal Plan for the Discontinuance Normally Includes:

- identification of the major assets to be disposed of;
- the expected method of disposal;
- the period expected to be required for completion of the disposal;
- the principal locations affected;
- the location, function, and approximate number or employees who will be compensated for terminating their services; and
- the estimated proceeds or salvage to be realised by disposal.

An enterprise's board of directors or similar governing body is considered to have made the announcement of a detailed, formal plan for discontinuance, if it has announced the main features of the plan to those affected by it, such as, lenders, stock exchanges, creditors, trade unions, etc, in a sufficiently specific manner so as to make the enterprise demonstrably committed to the discontinuance.

4. Recognition and Measurement

For recognizing and measuring the effect of discontinuing operations, this AS does provide any guidelines, but for the purpose the relevant Accounting Standards should be referred.

5. Presentation and Disclosure

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

a. A description of the discontinuing operation(s).

b. The business or geographical segment(s) in which it is reported as per AS 17.

c. The date and nature of the initial disclosure event.

d. The date or period in which the discontinuance is expected to be completed if known or determinable.

e. The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled.

f. The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period.

g. The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto and

h. The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

5.2 Disclosures other than Initial Disclosures Note: All the disclosures above should be presented in the notes to the financial statements except for amounts pertaining to pre-tax profit/loss of the discontinuing operation and the income tax expense thereon (second last bullet above) which should be shown on the face of the statement of profit and loss.

Disclosures as required by AS 4 Contingencies and Events Occurring After the Balance Sheet Date, are made if an initial disclosure event occurs between the balance sheet date and the date on which the financial statements for that period are approved by the board of directors in the case of a company or by the corresponding approving authority in the case of any other enterprise.

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

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

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

In addition to these disclosures, an enterprise should include, in its financial statements, for periods subsequent to the one in which the initial disclosure event occurs, a description of any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled and the events causing those changes. The disclosures should continue in financial statements for periods up to and including the period in which the discontinuance is completed. A discontinuance is completed when the plan is substantially completed or abandoned, though full payments from the buyer(s) may not yet have been received. 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. Any disclosures required by this Statement should be presented separately for each

discontinuing operation.

The disclosures should be presented in the notes to the financial statements except the following which should be shown on the face of the statement of profit and loss:

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

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

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

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

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

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

AS 25: Interim Financial Statement

1. Introduction

AS 25 does not mandate which enterprises should be required to present interim financial reports, how frequently, or how soon after the end of an interim period. If an enterprise is required or elects to prepare and present an interim financial report, it should comply with this Statement. The standard prescribes the minimum contents of an interim financial report and requires that an enterprise which elects to prepare and present an interim financial report, should comply with this standard. It also lays down the principles for recognition and measurement in a complete or condensed financial statements for an interim period. Timely and reliable interim financial reporting improves the ability of investors, creditors and others to understand an enterprise's capacity to generate earnings and cash flows, its financial condition and liquidity.

A statute governing an enterprise or a regulator may also require an enterprise to prepare and present certain information at an interim date which may be different in form and/or content as required by this Statement. In such a case, the recognition and measurement principles as laid down in this Statement are applied in respect of such information, unless otherwise specified in the statute or by the regulator.

2. Definitions of the Terms Used Under the Accounting Standard

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.

During the first year of operations of an enterprise, its annual financial reporting period may be shorter than a financial year. In such a case, that shorter period is not considered as an interim period.

3. Content of An Interim Financial Report

A complete set of financial statements normally includes Balance sheet, Statement of Profit & Loss, Cash flow statement and Notes including those relating to accounting policies and other statements and explanatory material that are an integral part of the financial statements.

The benefit of timeliness of presentation may be partially offset by a reduction in detail in the information provided. Therefore, this Statement requires preparation and presentation of an interim financial report containing, as a minimum, a set of condensed financial statements. Accordingly, it focuses on new activities, events, and circumstances and does not duplicate information previously reported. AS 25 does not prohibit or discourage an enterprise from presenting a complete set of financial statements in its interim financial report, rather than a set of condensed financial statements. The recognition and measurement principles set out in this Statement apply also to complete financial statements for an interim period, and such statements would include all disclosures required by this Statement as well as those required by other Accounting Standards. Minimum Components of an Interim Financial Report includes condensed Financial Statement.

4. Form and Content of Interim Financial Statements

If an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements.

If an enterprise prepares and presents a set of condensed financial statements in its interim financial report, those condensed statements should include, at a minimum, each of the headings and sub-headings that were included in its most recent annual financial statements and the selected explanatory notes as required by this Statement.

Additional line items or notes should be included if their omission would make the condensed interim financial statements misleading.

If an enterprise presents basic and diluted earnings per share in its annual financial statements in accordance with AS 20.

5. Selected Explanatory Notes

An enterprise should include the following information, as a minimum, in the notes to its interim financial statements, if material and if not disclosed elsewhere in the interim financial report:

a. A statement that the same accounting policies are followed in the interim financial statements as those followed in the most recent annual financial statements or, if those policies have been changed, a description of the nature and effect of the change.

b. Explanatory comments about the seasonality 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 as per AS 5.

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 prior financial years, if those changes have a material effect in the current interim period.

e. Issuances, buy-backs, repayments and restructuring of debt, equity and potential equity shares.

f. Dividends, aggregate or per share (in absolute or percentage terms), separately for equity shares and other shares.

g. Segment revenue, segment capital employed (segment assets minus segment liabilities) and segment result for business segments or geographical segments, whichever is the enterprise's primary basis of segment reporting (disclosure of segment information is required in an enterprise's interim financial report only if the enterprise is required, in terms of AS 17, Segment Reporting, to disclose segment information in its annual financial statements).

h. The effect of changes in the composition of the enterprise during the interim period, such as amalgamations, acquisition or disposal of subsidiaries and long-term investments, restructurings, and discontinuing operations and

i. Material changes in contingent liabilities since the last annual balance sheet date.

The above information should normally be reported on a financial year-to-date basis. However, the enterprise should also disclose any events or transactions that are material to an understanding of the current interim period.

6. Periods for which Interim Financial Statements are Required to be Presented

Interim reports should include interim financial statements (whether condensed or complete) for the periods listed in the following table:

Statement	Current	Comparative
Balance sheet	End of current interim period	End of immediately preceding financial year
Statement of profit and loss	Current interim period and cumulatively for the year-to-date	Comparable interim period and year-to-date of immediately preceding financial year
Cash flow statement	Cumulatively for the current financial year-to-date	Comparable year-to-date of immediately preceding financial year

7. Materiality

In deciding how to recognise, measure, classify, or disclose an item for interim financial reporting purposes, materiality should be assessed in relation to the interim period financial data. In making assessments of materiality, it should be recognised that interim measurements may rely on estimates to a greater extent than measurements of annual financial data. For reasons of understandability of the interim figures, materiality for making recognition and disclosure decision is assessed in relation to the interim period financial data. Thus, for example, unusual or extraordinary items, changes in accounting policies or estimates, and prior period items are recognised and disclosed based on materiality in relation to interim period data.

Illustration 1

Sincere Corporation is dealing in seasonal product sales pattern of the product, quarter wise is as follows:

1st quarter 30th June	10%
2nd quarter 30th September	10%
3rd quarter 31st December	60%
4th quarter 31st March	20%

Information regarding the 1st quarter ending on 30th June, 2012 is as follows:

Sales	80 crores
Salary and other expenses	60 crores
Advertisement expenses (routine)	4 crores
Administrative and selling expenses	8 crores

While preparing interim financial report for first quarter Sincere Corporation wants to defer Rs. 10 crores expenditure to third quarter on the argument that third quarter is having more sales therefore third quarter should be debited by more expenditure. Considering the seasonal nature of business and the expenditures are uniform throughout all quarters, calculate the result of the first quarter as per AS 25. Also give a comment on the company's view.

Solution

(Rs. in Crore)

Particulars		
Result of first quarter ending 30th June, 2012		
Turnover	80	
Other Income	Nil	
Total (a)		80
Less: Changes in inventories		
Salaries and other cost	Nil	
Administrative and selling Expenses (4+8)		60
Total (b)		12
Profit (a)-(b)		72

According to AS 25 the Income and Expense should be recognized when they are earned and incurred respectively. Therefore seasonal incomes will be recognized when they occur. Thus the company's view is not as per AS 25.

Illustration 2

The accounting year of X Ltd. ends on 30th September, 2012 and it makes its reports quarterly. However for the purpose of tax, year ends on 31st March every year. For the Accounting year beginning on 1-10-2011 and ends on 30-9-2012, the quarterly income is as under:-

1st quarter ending on 31-12-2011	Rs. 200 crores
2nd quarter ending on 31-3-2012	Rs. 200 crores
3rd quarter ending on 30-6-201	Rs. 200 crores
24th quarter ending on 30-9-2012	Rs. 200 crores
Total	Rs. 800 crores

Average actual tax rate for the financial year ending on 31-3-2012 is 20% and for financial year ending 31-3-2013 is 30%. Calculate tax expense for each quarter.

Solution

Calculation of tax expense

1st quarter ending on 31-12-2011	20020%	Rs. 40 lakhs
2nd quarter ending on 31-3-2012	20020%	Rs. 40 lakhs
3rd quarter ending on 30-6-2012	20030%	Rs. 60 lakhs
4th quarter ending on 30-9-2012	20030%	Rs. 60 lakhs

8. Disclosure in Annual Financial Statements

AS 5, requires disclosure, in financial statements, of the nature and (if practicable) the amount of a change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods. Similarly, if an estimate of an amount reported in an interim period is changed significantly during the final interim period of the financial year but a separate financial report is not prepared and presented for that final interim period, the nature and amount of that change in estimate should be disclosed in a note to the annual financial statements for that financial year.

9. Accounting Policies

9.1 Same Accounting Policies as annual financial statements: An enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. However, the frequency of an enterprise's reporting (annual, half-yearly, or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim

reporting purposes should be made on a year-to-date basis.

To illustrate:

a. The principles for recognising and measuring losses from inventory write-downs, restructurings, or impairments in an interim period are the same as those that an enterprise would follow if it prepared only annual financial statements. However, if such items are recognised and measured in one interim period and the estimate changes in a subsequent interim period of that financial year, the original estimate is changed in the subsequent interim period either by accrual of an additional amount of loss or by reversal of the previously recognised amount;

b. A cost that does not meet the definition of an asset at the end of an interim period is not deferred on the balance sheet date either to await future information as to whether it has met the definition of an asset or to smooth earnings over interim periods within a financial year; and

c. Income tax expense is recognised in each interim period based on the best estimate of the weighted average annual effective income tax rate expected for the full financial year. Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual effective income tax rate changes.

Income is recognised in the statement of profit and loss when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. Expenses are recognised in the statement of profit and loss when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. The recognition of items in the balance sheet which do not meet the definition of assets or liabilities is not allowed.

An enterprise that reports more frequently than half-yearly, measures income and expenses on a year-to-date basis for each interim period using information available when each set of financial statements is being prepared. Amounts of income and expenses reported in the current interim period will reflect any changes in estimates of amounts reported in prior interim periods of the financial year. The amounts reported in prior interim periods are not retrospectively adjusted. Paragraphs 16(d) and 25 require, however, that the nature and amount of any significant changes in estimates be disclosed.

9.2 Changes in Accounting Policies: Preparers of interim reports in compliance with AS 25 are required to consider any changes in accounting policies that will be applied for the next annual financial statements, and to implement the changes for interim reporting purposes.

If there has been any change in accounting policy since the most recent annual financial statements, the interim report is required to include a description of the nature and effect of the change.

10. Revenue Received Seasonally or Occasionally

Revenues that are received seasonally or occasionally within a financial year should not be anticipated or deferred as of an interim date if anticipation or deferral would not be appropriate at the end of the enterprise's financial year.

11. Cost Incurred Unevenly During the Financial Year

Costs that are incurred unevenly during an enterprise's financial year should be anticipated or deferred for interim reporting purposes if, and only if, it is also appropriate to anticipate or defer that type of cost at the end of the financial year.

A cost that does not meet the definition of an asset at the end of an interim period is not deferred in the interim balance sheet either to await future information as to whether it has met the definition of an asset, or to smooth earnings over interim periods within a financial year. Thus, when preparing interim financial statements, the enterprise's usual recognition and measurement practices are followed. The only costs that are capitalized are those incurred after the specific point in time at which the criteria for recognition of the particular class of asset are met. Deferral of costs as assets in an interim balance sheet in the hope that the criteria will be met before the year-end is prohibited.

12. Use of Estimates

The measurement procedures to be followed in an interim financial report should be designed to ensure that the resulting information is reliable and that all material financial information that is relevant to an understanding of the financial position or performance of the enterprise is appropriately disclosed.

13. Restatement of Previously Reported Interim Periods

One objective of the preceding principle is to ensure that a single accounting policy is applied to a particular class of transactions throughout an entire financial year. The effect of the principle requires that within the current financial year any change in accounting policy be applied retrospectively to the beginning of the financial year.

14. 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 (current and year-to-date) of the immediately preceding financial year; and

b. Comparative cash flow statement for the comparable year-to-date period of the immediately preceding financial year.

15. Applicability of AS 25 To Interim Financial Results, Accounting Standard (AS) 25, Interim Financial Reporting

The presentation and disclosure requirements contained in AS 25 should be applied only if an enterprise prepares and presents an 'interim financial report' as defined in AS 25. Accordingly, presentation and disclosure requirements contained in AS 25 are not required to be applied in respect of interim financial results (which do not meet the definition of 'interim financial report' as per AS 25) presented by an enterprise. For example, quarterly financial results presented under Clause 41 of the Listing Agreement entered into between Stock Exchanges and the listed enterprises do not meet the definition of 'interim financial report' as per AS 25. However, the recognition and measurement principles laid down in AS 25 should be applied for recognition and measurement of items contained in such interim financial results.

AS 26: Intangible Assets

1. Introduction

The standard prescribes the accounting treatment for intangible assets that are not dealt with specifically under other accounting standards, and requires an enterprise to recognise an intangible asset if, and only if, certain criteria are met. The standard specifies how to measure the carrying amount of intangible assets and requires certain disclosures about intangible assets.

2. Scope

This standard should be applied by all enterprises in accounting intangible assets, except

a. intangible assets that are covered by another AS,

b. financial assets,

c. rights and expenditure on the exploration for or development of minerals, oil, natural gas and similar non-regenerative resources,

d. intangible assets arising in insurance enterprise from contracts with policy holders,

e. expenditure in respect of termination benefits.

Exclusions from the scope of an Accounting Standard may occur if certain activities or transactions are so specialised that they give rise to accounting issues that may need to be dealt with in a different way. However, this Statement applies to other intangible assets used (such as computer software), and other expenditure (such as start-up costs), in extractive industries or by insurance enterprises. This Statement also applies to rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights. These items are excluded from the scope of AS 19.

3. Definitions

An asset is a resource:

a. Controlled by an enterprise as a result of past events and
b. From which future economic benefits are expected to flow to the enterprise.

Monetary assets are money held and assets to be received in fixed or determinable amounts of money.

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

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

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

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

A financial asset is any asset that is:

a. Cash,
b. A contractual right to receive cash or another financial asset from another enterprise,
c. A contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable or
d. An ownership interest in another enterprise.

4. Intangible Assets

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

The key components of the definition are:

- Identifiability; and
- Asset (the definition of which encompasses control).

Enterprises frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property, market knowledge and trademarks. Not all the items described above will meet the definition of an intangible asset, that is, identifiability, control over a resource and expectation of future economic benefits flowing to the enterprise. If an item covered by this Statement does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. In some cases, an asset may incorporate both intangible and tangible elements that are, in practice, inseparable. Judgement is required to assess as to which element is predominant. If use of physical assets is possible only with the intangible part of it, we treat them as Fixed Assets like Operating system for computers. If physical element is just to support intangible part of it, we treat them as intangible assets.

5. Identifiability

The definition of an intangible asset requires that an intangible asset be identifiable. To be identifiable, it is necessary that the intangible asset is clearly distinguished from goodwill. An intangible asset can be clearly distinguished from goodwill if the asset is separable. An asset is separable if the enterprise could rent, sell, exchange or distribute the specific future economic benefits attributable to the asset without also disposing of future economic benefits that flow from other assets used in the same revenue earning activity.

Though Separability is not a necessary condition for identifiability, if an asset generates future economic benefits only in combination with other assets, the asset is identifiable if the enterprise can identify the future economic benefits that will flow from the asset.

6. Control

An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. The capacity of an enterprise to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. However, legal enforceability of a right is not a necessary condition for control since an enterprise may be able to control the future economic benefits in some other way.

Market and technical knowledge may give rise to future economic benefits. An enterprise controls those benefits if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of trade agreement or by a legal duty on employees to maintain confidentiality. Future economic benefit is also flown from the skill of labour and customer loyalty but usually this flow of benefits cannot be controlled by the enterprise. As employees may quit the concern anytime or even loyal customers may decide to purchase goods and services from other suppliers. Moreover these items don't even qualify as intangible asset as per the definition given in this AS.

7. Future Economic Benefits

The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the enterprise.

8. Recognition and Initial Measurement of an Intangible Asset

The recognition of an item as an intangible asset requires an enterprise to demonstrate that the item meets the definition of an intangible asset and recognition criteria set out as below:

a. It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise. An enterprise uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence and

b. The cost of the asset can be measured reliably.

These recognition criteria apply to both costs incurred to acquire an intangible asset and those incurred to generate an asset internally. However, the standard also imposes certain additional criteria for the recognition of internally-generated intangible assets.

When assessing the probability of expected future economic benefits, reasonable and supportable assumptions should be used, representing management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

An intangible asset should be measured initially at cost.

9. Separate Acquisition

If an intangible asset is acquired separately, the cost of the intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

10. Acquisition as part of an Amalgamation

An intangible asset acquired in an amalgamation in the nature of purchase is accounted for in accordance with AS 14. In accordance with this Statement:

a. A transferee recognises an intangible asset that meets the recognition criteria, even if that intangible asset had not been recognised in the financial statements of the transferor and

b. If the cost (i.e. fair value) of an intangible asset acquired as part of an amalgamation in the nature of purchase cannot be measured reliably, that asset is not recognised as a separate intangible asset but is included in goodwill.

Hence, judgement is required to determine whether the cost (i.e. fair value) of an intangible asset acquired in an amalgamation can be measured with sufficient reliability for the purpose of separate recognition. Quoted market prices in an active market provide the most reliable measurement of fair value. The appropriate market price is usually the current bid price. If current bid prices are unavailable, the price of the most recent similar transaction may provide a basis from which to estimate fair value, provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the asset's fair value is estimated.

If no active market exists for an asset, its cost reflects the amount that the enterprise would have paid, at the date of the acquisition, for the asset in an arm's length transaction between knowledgeable and willing parties, based on the best information available. The cost initially recognised for the intangible asset in this case is restricted to an amount that does not create or increase any capital reserve arising at the date of the amalgamation. Certain enterprises that are regularly involved in the purchase and sale of unique intangible assets have developed techniques for estimating their fair values indirectly. These techniques include, where appropriate, applying multiples reflecting current market transactions to certain indicators driving the profitability of the asset (such as revenue, market shares, operating profit, etc.) or discounting estimated future net cash flows from the asset.

11. Acquisition by way of a Government Grant

In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant.

This may occur when a government transfers or allocates to an enterprise intangible assets such as airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources.

AS 12, requires that government grants in the form of non-monetary assets, given at a concessional rate should be accounted for on the basis of their acquisition cost. Accordingly, intangible asset acquired free of charge, or for nominal consideration, by way of government grant is recognised at a nominal value or at the acquisition cost, as appropriate; any expenditure that is directly attributable to making the asset ready for its intended use is also included in the cost of the asset.

12. Internally Generated Intangible Assets

To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into Research Phase & Development Phase. If an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only.

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.

13. Research Phase

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding. No intangible asset arising from research or from the research phase should be recognised. Expenditure on research or on the research phase should be recognised as an expense when it is incurred.

Examples of research activities are:

a. Activities aimed at obtaining new knowledge.

b. The search for, evaluation and final selection of, applications of research findings or other knowledge.

c. The search for alternatives for materials, devices, products, processes, systems or services;

d. The formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

14. Development Phase

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

An intangible asset arising from development or from the development phase should be recognised if, and only if, an enterprise can demonstrate all of the following:

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.

Examples of development activities are:

a. The design, construction and testing of pre-production or pre-use prototypes and models.

b. The design of tools, jigs, moulds and dies involving new technology.

c. The design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production and

d. The design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

An enterprise assesses the future economic benefits to be received from the asset using the principles in Accounting Standard on Impairment of Assets.

An enterprise's costing systems can often measure reliably the cost of generating an intangible asset internally, such as salary and other expenditure incurred in securing copyrights or licences or developing computer software.

This Statement takes the view that expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

15. Cost of an Internally Generated Intangible Asset

The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and making the asset ready for its intended use from the time when the intangible asset first meets the recognition criteria. The cost includes, if applicable:

a. Expenditure on materials and services used or consumed in generating the intangible asset.

b. The salaries, wages and other employment related costs of personnel directly engaged in generating the asset.

c. Any expenditure that is directly attributable to generating the asset, such as fees to register a legal right and the amortisation of patents and licences that are used to generate the asset and

d. Overheads that are necessary to generate the asset and that can be allocated on a reasonable and consistent basis to the asset. Allocations of overheads are made on bases similar to those discussed in AS 2 & AS 16.

The following are not components of the cost of an internally generated intangible asset:

a. Selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to making the asset ready for use.

b. Clearly identified inefficiencies and initial operating losses incurred before an asset achieves planned performance and

c. Expenditure on training the staff to operate the asset.

16. Items to be Recognised as an Expense

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

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

b. The item is acquired in an amalgamation in the nature of purchase and cannot be recognised as an intangible asset. It forms part of the amount attributed to goodwill (capital reserve) at the date of acquisition.

AS 26 states that the following types of expenditure which should always be recognised as an expense when it is incurred:

- Research;
- Start-up activities (start-up costs), unless the expenditure qualifies to be included in the cost of a tangible fixed asset. Start-up costs include:
- Preliminary expenses incurred in establishment of a legal entity; such as legal and secretarial costs;
- Expenditure to open a new facility or business (i.e. pre-opening costs); and
- Expenditure prior to starting new operations or launching new products or processes (i.e. pre-operating costs);
- Training activities;
- Advertising and promotional activities; and
- Relocating or re-organising part or all of an enterprise.

It does not apply to payments for the delivery of goods or services made in advance of the delivery of goods or the rendering of services. Such prepayments are recognised as assets.

Expenses recognized as expenses cannot be reclassified as cost of Intangible Asset in later years.

17. Subsequent Expenditure

Subsequent expenditure on an intangible asset after its purchase or its completion should be recognised as an expense when it is incurred unless:

a. 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

b. The expenditure can be measured and attributed to the asset reliably.

If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.
Subsequent expenditure on brands, mastheads, publishing titles, customer lists and items similar in substance is always recognised as an expense to avoid the recognition of internally generated goodwill. After initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses.

18. Amortisation Period

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 use. Estimates of the useful life of an intangible asset generally become less reliable as the length of the useful life increases. This Statement adopts a presumption that the useful life of intangible assets is unlikely to exceed ten years.

In some cases, there may be persuasive evidence that the useful life of an intangible asset will be a specific period longer than ten years. In these cases, the presumption that the useful life generally does not exceed ten years is rebutted and the enterprise:

a. Amortises the intangible asset over the best estimate of its useful life.

b. Estimates the recoverable amount of the intangible asset at least annually in order to identify any impairment loss and

c. Discloses the reasons why the presumption is rebutted and the factor(s) that played a significant role in determining the useful life of the asset.

If control over the future economic benefits from an intangible asset is achieved through legal rights that have been granted for a finite period, the useful life of the intangible asset should not exceed the period of the legal rights unless the legal rights are renewable and renewal is virtually certain. There may be both economic and legal factors influencing the useful life of an intangible asset: economic factors determine the period over which future economic benefits will be generated; legal factors may restrict the period over which the enterprise controls access to these benefits. The useful life is the shorter of the periods determined by these factors.

19. Amortisation Method

A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the unit of production method. The method used for an asset is selected based on the expected pattern of consumption of economic benefits and is consistently applied from period to period, unless there is a change in the expected pattern of consumption of economic benefits to be derived from that asset. There will rarely, if ever, be persuasive evidence to support an amortisation method for intangible assets that results in a lower amount of accumulated amortisation than under the straight-line method.

The amortisation charge for each period should be recognised as an expense unless another Accounting Standard permits or requires it to be included in the carrying amount of another asset.

20. Residual Value

The residual value of an intangible asset should be assumed to be zero unless:

a. There is a commitment by a third party to purchase the asset at the end of its useful life or
b. There is an active market for the asset and:
   i Residual value can be determined by reference to that market and
   ii. It is probable that such a market will exist at the end of the asset's useful life.

21. Review of Amortisation Period and Amortisation Method

During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. Over time, the pattern of future economic benefits expected to flow to an enterprise from an intangible asset may change. Therefore, the amortisation period and the amortisation method should be reviewed at least at each financial year

end. If the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly. If there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern. Such changes should be accounted for in accordance with AS 5.

22. Recoverability of the Carrying Amount-impairment Losses

Impairment losses of intangible assets are calculated on the basis of AS 28, which will be discussed in the later units of this chapter. If an impairment loss occurs before the end of the first annual accounting period commencing after acquisition for an intangible asset acquired in an amalgamation in the nature of purchase, the impairment loss is recognised as an adjustment to both the amount assigned to the intangible asset and the goodwill (capital reserve) recognised at the date of the amalgamation. However, if the impairment loss relates to specific events or changes in circumstances occurring after the date of acquisition, the impairment loss is recognised under AS 28 and not as an adjustment to the amount assigned to the goodwill (capital reserve) recognised at the date of acquisition. In addition to the requirements of AS 28, an enterprise should estimate the recoverable amount of the following intangible assets at least at each financial year end even if there is no indication that the asset is impaired:

a. An intangible asset that is not yet available for use and

b. An intangible asset that is amortised over a period exceeding ten years from the date when the asset is available for use.

The recoverable amount should be determined under AS 28 and impairment losses recognised accordingly.

If the useful life of an intangible asset was estimated to be less than ten years at initial recognition, but the useful life is extended by subsequent expenditure to exceed ten years from when the asset became available for use, an enterprise performs the required impairment test and makes the disclosure required.

23. Retirements and Disposals

An intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

24. Disclosure

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

a. The useful lives or the amortisation rates used.

b. The amortisation methods used.

c. The gross carrying amount and the accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period.

d. 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.
   iv. Impairment losses reversed in the statement of profit and loss during the period.
   v. Amortisation recognised during the period and
   vi. Other changes in the carrying amount during the period.

The financial statements should also disclose:

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 disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

25. Transitional Provisions

Where, on the date of this Statement coming into effect, an enterprise is following an accounting policy of not amortising an intangible item or amortising an intangible item over a period longer than the period determined under this Statement and the period determined has expired on the date of this Statement coming into effect, the carrying amount appearing in the balance sheet in respect of that item should be eliminated with a corresponding adjustment to the opening balance of revenue reserves.

In the event the period determined has not expired on the date of this Statement coming into effect and:

a. If the enterprise is following an accounting policy of not amortising an intangible item, the carrying amount of the intangible item should be restated, as if the accumulated amortisation had always been determined under this Statement, with the corresponding adjustment to the opening balance of revenue reserves. The restated carrying amount should be amortised over the balance of the period.

b. If the remaining period as per the accounting policy followed by the enterprise:

   i. Is shorter as compared to the balance of the period determined, the carrying amount of the intangible item should be amortised over the remaining period as per the accounting policy followed by the enterprise,

   ii. Is longer as compared to the balance of the period determined, the carrying amount of the intangible item should be restated, as if the accumulated amortisation had always been determined under this Statement, with the corresponding adjustment to the opening balance of revenue reserves. The restated carrying amount should be amortised over the balance of the period.

26. Illustrations

Illustration 1

Dell International Ltd. is developing a new production process. During the financial Year 31st March, 2011, the total expenditure incurred on this process was Rs. 40 lakhs. The production process met the criteria for recognition as an intangible asset on 1st 2010. Expenditure incurred till this date was Rs. 16 lakhs.

Further expenditure incurred on the process for the financial year ending 31st March 2013, was Rs. 70 lakhs. As at 31-3-2013, the recoverable amount of know-how embodied in the process is estimated to be Rs. 62 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to work out:

a. What is the expenditure to be charged to the profit and loss account for the financial year ended 31st March 2011? (Ignore depreciation for this purpose)

b. What is the carrying amount of the intangible asset as at 31st March 2011?

c. What is the expenditure to be charged to the profit and loss account for the financial year ended 31st March 2012? (Ignore depreciation for this purpose)

d. What is the carrying amount of the intangible asset as at 31st March 2012?

Solution

a. Rs. 22 lakhs

b. Carrying amount as on 31-3-2011 will be expenditure incurred after 1-12-2010= Rs. 24 lakhs

c. Book cost of intangible asset as on 31-3-2012 is as follows

   Total Book cost = Rs. (70 + 24) lakhs = Rs. 94 lakhs
   Recoverable amount as estimated = Rs. 62 lakhs
   Difference to be charged to Profit and Loss account = Rs. 32 lakhs

d. Rs. 62 lakhs

Illustration 2

A Pharma Company spent Rs. 33 lakhs during the accounting year ended 31st March, 2012 on a research project to develop a drug to treat "AIDS". Experts are of the view that it may take four years to establish whether the drug will be effective or not and even if found effective it may take two to three more years to produce the medicine, which can be marketed. The company wants to treat the expenditure as deferred revenue expenditure. Comment.

Solution

As per para 41 of AS 26 'Intangible Assets', no intangible asset arising from research (or from the research phase of an internal project) should be recognized. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred. Thus the company cannot treat the expenditure as deferred revenue expenditure. The entire amount of Rs. 33 lakhs spent on research project should be charged as an expense in the year ended 31st March, 2012.

Illustration 3

Swift Ltd. acquired a patent at a cost of Rs. 80,00,000 for a period of 5 years and the product life-cycle is also 5 yeaRs. The company capitalized the cost and started amortizing the asset at Rs. 10,00,000 per annum. After two years it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be Rs. 36,00,000, Rs. 46,00,000, Rs. 44,00,000, Rs. 40,00,000 and Rs. 34,00,000. Find out the amortization cost of the patent for each of the years.

Solution

Swift Limited amortised Rs. 10,00,000 per annum for the first two years i.e. Rs. 20,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	Net cash flows Rs.	Amortization Ratio	Amortization Amount Rs.
I	-	0.125	10,00,000
II	-	0.125	10,00,000
III	36,00,000	0.180	10,80,000
IV	46,00,000	0.230	13,80,000
V	44,00,000	0.220	13,20,000
VI	40,00,000	0.200	12,00,000
VII	34,00,000	0.170	10,20,000
Total	2,00,00,000	1.000	80,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., Rs. 60,00,000 has been amortized in the ratio of net cash flows arising from the product of Swift Ltd.

It has been assumed that the company had amortized the patent at Rs. 10,00,000 per annum in the first two years on the basis of economic benefits derived from the product manufactured under the patent.

Note: The answer has been given on the basis that the patent is renewable and Swift Ltd. got it renewed after expiry of five years.

Illustration 4

During 2011, an enterprise incurred costs to develop and produce a routine, low risk computer software product, as follows:

	Amount (Rs.)
Completion of detailed programme and design	25,000
Coding and Testing	20,000
Other coding costs	42,000
Testing costs	12,000
Product masters for training materials	13,000
Duplication of computer software and training materials, from product masters (2,000 units)	40,000
Packing the product (1,000 units)	11,000

What amount should be capitalized as software costs in the books of the company, on Balance Sheet date?

Solution

As per para 44 of AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed programme design or working model. In this case, Rs. 45,000 would be recorded as an expense (Rs. 25,000 for completion of detailed program design and Rs. 20,000 for coding and testing to establish technological feasibility/asset recognition criteria). Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (Rs. 42,000 + Rs. 12,000 + Rs. 13,000) Rs. 67,000.

AS 28: Impairment of Assets

1. Introduction

This standard prescribes the procedures to be applied to ensure that the assets of an enterprise are carried at an amount not exceeding their recoverable amount (amount to be recovered through use or sale of the asset). The standard also lays down principles for reversal of impairment losses and prescribes certain disclosures in respect of impaired assets. An enterprise is required to assess at each balance sheet date whether there is an indication that an enterprise may be impaired. If such an indication exists, the enterprise is required to estimate the recoverable amount and the impairment loss, if any, should be recognised in the profit and loss account.

2. Scope

The standard should be applied in accounting for impairment of all assets except

1. inventories (AS 2),
2. assets arising under construction contracts (AS 7),
3. financial assets including investments covered under AS 13, and deferred tax assets (AS 22).

There are chances that the provision on account of impairment losses may increase sickness of companies and potentially sick companies may actually become sick.

Therefore, AS 28 applies to (among other assets):

- Land and buildings;
- Plant and machinery;
- Investment property;
- Intangible assets;
- Goodwill;
- Assets carried at revalued amounts under AS 10.

3. Assessment

An enterprise should assess at each balance sheet date whether there is any indication that an asset may be impaired. If any such indication exists, the enterprise should estimate the recoverable amount of the asset. An asset is impaired when the carrying amount of the asset exceeds its recoverable amount. In assessing whether there is any indication that an asset may be impaired, an enterprise should consider, as a minimum, the following indications:

External sources of information

a. During the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use.

b. Significant changes with an adverse effect on the enterprise have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the enterprise operates or in the market to which an asset is dedicated.

c. Market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially.

d. The carrying amount of the net assets of the reporting enterprise is more than its market capitalization.

Internal sources of information

a. Evidence is available of obsolescence or physical damage of an asset.

b. Significant changes with an adverse effect on the enterprise have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include plans to discontinue or restructure the operation to which an asset belongs or to

dispose of an asset before the previously expected date and

c. Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

The concept of materiality applies in identifying whether the recoverable amount of an asset needs to be estimated.

If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation method or the residual value for the asset need to be reviewed and adjusted under the Accounting Standard 6, even if no impairment loss is recognised for the asset.

4. Measurement of Recoverable Amount

Recoverable Amount is the higher of an asset's net selling price and its value in use.
Recoverable amount for an asset is defined by the statement as the higher of net selling price or value of use whichever is higher. If there is no reason to believe that an asset's value in use materially exceeds its net selling price, the asset's recoverable amount may be taken to be its net selling price. This will often be the case for an asset that is held for disposal. Otherwise, if it is not possible to determine the selling price we take value in use of assets as it's recoverable amount.

Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows from continuing use that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs, unless either:

a. The asset's net selling price is higher than its carrying amount; or

b. The asset's value in use can be estimated to be close to its net selling price and net selling price can be determined.

Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.

Costs of disposal are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.

The best evidence for net selling price is a price in the bidding sales agreement for the disposal of the assets or similar assets. In the absence of this net selling price is estimated from the transactions for the assets in active market, if the asset has the active market. If there is no binding sale agreement or active market for an asset, net selling price is based on the best information available to reflect the amount that an enterprise could obtain, at the balance sheet date, for the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal.

Value in Use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

Estimating the value in use of an asset involves the following steps:

a. Estimating the future cash inflows and outflows arising from continuing use of the asset and from its ultimate disposal; and

b. Applying the appropriate discount rate to these future cash flows.

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

Carrying amount is the amount at which an asset is recognised in the balance sheet after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.

Depreciation (Amortisation) is a systematic allocation of the depreciable amount of an asset over its useful life.

Depreciable amount is the cost of an asset, or other amount substituted for cost in the financial statements, less its residual value.

Useful life is either:

- The period of time over which an asset is expected to be used by the enterprise; or
- The number of production or similar units expected to be obtained from the asset by the enterprise.

5. Basis For Estimates of Future Cash Flows

Cash flow projections should be based on the most recent budgets/forecasts for a maximum of five years. Financial budgets/forecasts over a period longer than five years may be used if management is confident that these projections are reliable and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period.

Cash flow projections until the end of an asset's useful life are estimated by extrapolating the cash flow projections based on the financial budgets/forecasts using a growth rate for subsequent years. This rate is steady or declining. This growth rate should not exceed the long-term average growth rate for the products, industries, or country or countries in which the enterprise operates, or for the market in which the asset is used, unless a higher rate can be justified.

Cash flow projections should be based on reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset. Greater weight should be given to external evidence.

6. Composition of Estimates of Future Cash Flows

Estimates of future cash flows should include (i) Projections of net cash inflows from the continuing use of the asset and (ii) Net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life.

Care should be taken for the following points:

a. When the carrying amount of an asset does not yet include all the cash outflows to be incurred before it is ready for use or sale, estimate of any further cash outflow that is expected to be incurred before the asset is ready for use or sale should be included.

b. Cash inflows from assets that generate cash inflows from continuing use that are largely independent of the cash

inflows from the asset under review should not be included.

c. Cash outflows that relate to obligations that have already been recognised as liabilities to be excluded.

d. Future cash outflows or inflows expected to arise because of restructuring of the organization should be not considered.

e. Any future capital expenditure enhancing the capacity of the assets should be excluded.

f. Any increase in expected cash inflow from the above expenditure should also be excluded.

g. Estimates of future cash flows should not include cash inflows or outflows from financing activities and also income tax receipts or payments.

Foreign Currency Future Cash Flows are estimated in the currency it will be generated and after they are discounted for the time value of money, we convert them in the reporting currency on the basis of AS 11.

Discount Rate

The discount rate(s) should be a pre tax rate(s) that reflect(s) current market assessments of the time value of money and the risks specific to the asset. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted. A rate that reflects current market assessments of the time value of money and the risks specific to the asset is the return that investors would require if they were to choose an investment that would generate cash flows of amounts, timing and risk profile equivalent to those that the enterprise expects to derive from the asset.

7. Recognition and Measurement of an Impairment Loss

If recoverable amount of assets more than carrying amount, we ignore the difference and asset is carried on at the same book value. But when this recoverable amount is less than the carrying amount, this difference termed as Impairment Loss should be written off immediately as expenses to Profit & Loss Account. If assets are carried out at revalued figures then the impairment loss equivalent to revalued surplus is adjusted with it and the balance (if any) is charged to Profit & Loss Account. Depreciation for the coming years on the assets are recalculated on the basis new carrying amount, residual value and remaining useful life of the asset, according to AS 6.

A cash generating unit is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.

8. Identification of the Cash-generating Unit to which an Asset Belongs

If there is any indication that an asset may be impaired, the recoverable amount should be estimated for the individual asset, if it is not possible to estimate the recoverable amount of the individual asset because the value in use of the asset cannot be determined and it is probably different from scrap value. Therefore, the enterprise estimates the recoverable amount of the cash-generating unit to which the asset belongs.

If recoverable amount cannot be determined for an individual asset, an enterprise identifies the lowest aggregation of assets that generate largely independent cash inflows from continuing use. Even if part or all of the output produced

by an asset or a group of assets is used by other units of the reporting enterprise, this asset or group of assets forms a separate cash-generating unit if the enterprise could sell this output in an active market. This is because this asset or group of assets could generate cash inflows from continuing use that would be largely independent of the cash inflows from other assets or groups of assets. In using information based on financial budgets/forecasts that relates to such a cash-generating unit, an enterprise adjusts this information if internal transfer prices do not reflect management's best estimate of future market prices for the cash-generating unit's output. Cash-generating units should be identified consistently from period to period for the same asset or types of assets, unless a change is justified.

9. Recoverable Amount and Carrying Amount of a Cash-generating Unit

The carrying amount of a cash-generating unit should be determined consistently with the way the recoverable amount of the cash-generating unit is determined i.e. carrying amount is the summation of the carrying amount of all the assets grouped under one cash-generating unit. This also includes the liability only if that liability is necessary to be considered to determine the recovery amount. This may occur if the disposal of a cash-generating unit would require the buyer to take over a liability. In this case, the net selling price of the cash-generating unit is the estimated selling price for the assets of the cash-generating unit and the liability together, less the costs of disposal. In order to perform a meaningful comparison between the carrying amount of the cash-generating unit and its recoverable amount, the carrying amount of the liability is deducted in determining both the cash-generating unit's value in use and its carrying amount. For practical reasons, the recoverable amount of a cash-generating unit is sometimes determined after consideration of assets that are not part of the cash-generating unit or liabilities that have already been recognised in the financial statements. In such cases, the carrying amount of the cash-generating unit is increased by the carrying amount of those assets and decreased by the carrying amount of those liabilities.

10. Goodwill

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 cannot be determined. As a consequence, if there is an indication that goodwill may be impaired, recoverable amount is determined for the cash-generating unit to which goodwill belongs. This amount is then compared to the carrying amount of this cash-generating unit and any impairment loss is recognized. If goodwill can be allocated on a reasonable and consistent basis, an enterprise applies the 'bottom-up' test only. If it is not possible to allocate goodwill on a reasonable and consistent basis, an enterprise applies both the 'bottom-up' test and 'top-down' test.

11. Corporate Assets

Key characteristics of corporate assets are that they do not generate cash inflows independently from other assets or groups of assets and their carrying amount cannot be fully attributed to the cash-generating unit under review.

In testing a cash-generating unit for impairment, an enterprise should identify all the corporate assets that relate to the cash-generating unit under review. For each identified corporate asset:

a. If the carrying amount of the corporate asset can be allocated on a reasonable and consistent basis to the cash-generating unit under review, an enterprise should apply the 'bottom-up' test only; and

b. If the carrying amount of the corporate asset cannot be allocated on a reasonable and consistent basis to the

cash-generating unit under review, an enterprise should apply both the 'bottom-up' and 'top-down' tests.

12. Impairment Loss for a Cash-generating Unit

The impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:

a. First, to goodwill allocated to the cash-generating unit (if any); and
b. Then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.

These reductions in carrying amounts should be treated as impairment losses on individual assets

The carrying amount of an asset should not be reduced below the highest of:

a. Its net selling price (if determinable);
b. Its value in use (if determinable); and
c. Zero.

The amount of the impairment loss that would otherwise have been allocated to the asset should be allocated to the other assets of the unit on a pro-rata basis.

13. Reversal of an Impairment Loss

An enterprise should assess at each balance sheet date whether there is any indication that an impairment loss recognised for an asset in prior accounting periods may no longer exist or may have decreased. If any such indication exists, the enterprise should estimate the recoverable amount of that asset. An impairment loss recognised for an asset in prior accounting periods should be reversed if there has been a change in the estimates of cash inflows, cash outflows or discount rates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset should be increased to its recoverable amount. That increase is a reversal of an impairment loss. Indications of a potential decrease in an impairment loss are mainly mirror the indications of a potential impairment loss discussed above as external and internal indicators. The concept of materiality applies in identifying whether an impairment loss recognised for an asset in prior accounting periods may need to be reversed and the recoverable amount of the asset determined.

14. Reversal of an Impairment Loss for an Individual Asset

If impairment loss was written off to profit and loss account, then the reversal of impairment loss should be recognized as income in the financial statement immediately. If impairment loss was adjusted with the Revaluation Reserve as per AS 10; then reversal of impairment loss will be written back to the reserve account to the extent it was adjusted, any surplus will be recognised as revenue. But in any case 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 (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior accounting periods. This is mainly because any further increase in value of asset is revaluation, which is governed by AS 10.

After a reversal of an impairment loss is recognised, the depreciation (amortisation) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

15. Reversal of an Impairment Loss for a Cash-generating Unit

A reversal of an impairment loss for a cash-generating unit should be allocated to increase the carrying amount of the assets of the unit in the following order:

a. First, assets other than goodwill on a pro-rata basis based on the carrying amount of each asset in the unit; and
b. Then, to goodwill allocated to the cash-generating unit (if any),

16. Reversal Of An Impairment Loss for Goodwill

This Statement 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 a subsequent period unless:

a. The impairment loss was caused by a specific external event of an exceptional nature that is not expected to recur; and

b. Subsequent external events have occurred that reverse the effect of that event.

17. Impairment in Case of Discontinuing Operations

In applying this Statement to a discontinuing operation, an 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 the enterprise sells the discontinuing operation substantially in its entirety, none of the assets of the discontinuing operation generate cash inflows independently from other assets within the discontinuing operation. Therefore, recoverable amount is determined for the discontinuing operation as a whole and an impairment loss, if any, is allocated among the assets of the discontinuing operation in accordance with this Statement;

b. If the enterprise disposes of the discontinuing operation in other ways such as piecemeal sales, the recoverable amount is determined for individual assets, unless the assets are sold in groups; and

c. If the enterprise abandons the discontinuing operation, the recoverable amount is determined for individual assets as set out in this Statement.

18. Disclosure

For each class of assets, 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 item(s) of 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 item(s) of the statement of profit and loss in which those impairment losses are reversed;

c. The amount of impairment losses recognised directly against revaluation surplus during the period; and

d. The amount of reversals of impairment losses recognised directly in revaluation surplus during the period.

An enterprise that applies AS 17, Segment Reporting, should disclose the following for each reportable segment based on an enterprise's primary format (as defined in AS 17):

a. The amount of impairment losses recognised in the statement of profit and loss and directly against revaluation surplus during the period; and

b. The amount of reversals of impairment losses recognised in the statement of profit and loss and directly in revaluation surplus during the period.

If an impairment loss for an individual asset or a cash-generating unit is recognised or reversed during the period and is material to the financial statements of the reporting enterprise as a whole, an enterprise should disclose:

a. The events and circumstances that led to the recognition or reversal of the impairment loss;

b. The amount of the impairment loss recognised or reversed;

c. For an individual asset:

i. The nature of the asset; and

ii. The reportable segment to which the asset belongs, based on the enterprise's primary format (as defined in AS 17, Segment Reporting);

d. For a cash-generating unit:

i. A description of the cash-generating unit (such as whether it is a product line, a plant, a business operation, a geographical area, a reportable segment as defined in AS 17 or other);

ii. The amount of the impairment loss recognised or reversed by class of assets and by reportable segment based on the enterprise's primary format (as defined in AS 17); and

iii. If the aggregation of assets for identifying the cash-generating unit has changed since the previous estimate of the cash-generating unit's recoverable amount (if any), the enterprise should describe the current and former way of aggregating assets and the reasons for changing the way the cash-generating unit is identified;

e. Whether the recoverable amount of the asset (cash-generating unit) is its net selling price or its value in use;

f. If recoverable amount is net selling price, the basis used to determine net selling price (such as whether selling price was determined by reference to an active market or in some other way); and

g. If recoverable amount is value in use, the discount rate(s) used in the current estimate and previous estimate (if any) of value in use.

If impairment losses recognised (reversed) during the period are material in aggregate to the financial statements of

the reporting enterprise as a whole, an enterprise should disclose a brief description of the following:

a. The main classes of assets affected by impairment losses (reversals of impairment losses);

b. The main events and circumstances that led to the recognition (reversal) of these impairment losses.

19. Transitional Provisions

On the date of this Statement becoming mandatory, an enterprise should assess whether there is any indication that an asset may be impaired (see paragraphs 5-13). If any such indication exists, the enterprise should determine impairment loss, if any, in accordance with this Statement. The impairment loss, so determined, should be adjusted against opening balance of revenue reserves being the accumulated impairment loss relating to periods prior to this Statement becoming mandatory unless the impairment loss is on a revalued asset. An impairment loss on a revalued asset should be recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset. If the impairment loss exceeds the amount held in the revaluation surplus for that same asset, the excess should be adjusted against opening balance of revenue reserves. Any impairment loss arising after the date of this Statement becoming mandatory should be recognised in accordance with this Statement (i.e., in the statement of profit and loss unless an asset is carried at revalued amount. An impairment loss on a revalued asset should be treated as a revaluation decrease).

Illustrations

Illustration 1

Ergo Industries Ltd. gives the following estimates of cash flows relating to fixed asset on 31-12-2010. The discount is 15%.

Year	Cash Flow (Rs. In lakhs)
2011	4000
2012	6000
2013	6000
2014	8000
2015	4000

Residual value at the end of 2015 = Rs. 1000 lakhs

Fixed Asset purchased on 1-1-2008 = Rs. 40,000 lakhs

Useful life = 8 years

Net selling price on 31-12-2015 = Rs. 20,000 lakhs

Calculate on 31-12-2010:

a. Carrying amount at the end of 2010
b. Value in use on 31-12-2010
c. Recoverable amount on 31-12-2010
d. Impairment loss to be recognized for the year ended 31-12-2010
e. Revised carrying amount
f. Depreciation charge for 2011

Solution

Calculation of value in use

Year	Cash Flow	Discount as per 15%	Discounted cash flow
2011	4000	0.870	3480
2012	6000	0.756	4536
2013	6000	0.658	3948
2014	8000	0.572	4576
2015	4000	0.497	1988

Value in use = Rs. 18528 lakhs

Calculation of carrying amount:

Original cost = Rs. 20,000 lakhs

Depreciation for 3 years = [(40,000-1000)3/8] = Rs. 14,625

Carrying amount on 31-12-2010 = [40,000-14,625] = Rs. 25,375
Recoverable amount = Rs. 20,000 lakhs
Impairment Loss = Rs. (25,375-20,000) = Rs. 5,375 lakhs
Revised carrying amount = Rs. (25,375-5,375) = Rs. 20,000 lakhs
Depreciation Charge for 2011 = (20,000-1000)/5 = Rs. 3,800

Illustration 2

X Ltd. is having a plant (asset) carrying amount of which is Rs. 100 lakhs on 31.3.2004. Its balance useful life is 5 years and residual value at the end of 5 years is Rs. 5 lakhs. Estimated future cash flow from using the plant in next 5 years are:-

For the year ended on	Estimated cash flow (Rs. in lakhs)
31.3.2011	50
31.3.2012	30
31.3.2013	30
31.3.2014	20
31.3.2015	20

Calculate "value in use" for plant if the discount rate is 10% and also calculate the recoverable amount if net selling price of plant on 31.3.2010 is Rs. 60 lakhs.

Solution

Present value of future cash flow

Year ended	Future Cash Flow	Discount @ 10% Rate	Discounted cash flow
31.3.2011	50	0.909	45.45
31.3.2012	30	0.826	24.78
31.3.2013	30	0.751	22.53
31.3.2014	20	0.683	13.66
31.3.2015	20	0.620	12.40
			118.82
Present value of residual price on 31.3.2015 = 5x0.620			3.10
Present value of estimated cash flow by use of an asset and residual value, which is called "value in use".			121.92

If net selling price of plant on 31.3.2010 is Rs. 60 lakhs, the recoverable amount will be higher of Rs. 121.92 lakhs (value in use) and Rs. 60 lakhs (net selling price), hence recoverable amount is Rs. 121.92 lakhs

AS 29: Provisions, Contingent Liabilities and Contingent Assets

1. Introduction

The objective of AS 29 is to ensure that appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities and sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount. This standard applies in accounting for provisions and contingent liabilities and contingent assets resulting from financial instruments (not carried at fair value) and insurance enterprises (other than those arising from contracts with policyholders).

The standard will not apply to provisions/liabilities resulting from executing controls and those covered under any other accounting standard.

2. Scope

This Statement should be applied in accounting for provisions and contingent liabilities and in dealing with contingent assets, other than

a. Those resulting from financial instruments that are carried at fair value;
b. Those resulting from executory contracts;
c. Those arising in insurance enterprises from contracts with policy-holders; and
d. Those covered by another Accounting Standard.

Where another Accounting Standard like 7; 9; 15; 19; 22 & 24 deals with a specific type of provision, contingent liability or contingent asset, an enterprise applies that Statement instead of this Statement.

3. Definitions

Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

Examples of executory contracts include:

- Employee contracts in respect of continuing employment;
- Contracts for future delivery of services such as gas and electricity;
- Obligations to pay local authority charges and similar levies; and
- Most purchase orders.

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

A **Liability** is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

An **Obligating event** is an event that creates an obligation that results in an enterprise having no realistic alternative to settling that obligation.

A Contingent liability is:

a. A possible obligation that arises from past events and the existence of which will be confirmed only by the

occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

b. A present obligation that arises from past events but is not recognised because:
   i. It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

   ii. A reliable estimate of the amount of the obligation cannot be made.

   A Contingent asset is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

   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.

   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.

A Restructuring is a programme that is planned and controlled by management, and materially changes either:
a. The scope of a business undertaken by an enterprise; or
b. The manner in which that business is conducted.

4. Provisions

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.

5. Present Obligation

An enterprise determines whether a present obligation exists at the balance sheet date by taking account of all available evidence. On the basis of such evidence:

a. Where it is more likely than not that a present obligation exists at the balance sheet date, the enterprise recognises a provision (if the recognition criteria are met); and

b. Where it is more likely that no present obligation exists at the balance sheet date, the enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote.

6. Past Event

A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the enterprise has no realistic alternative to settling the obligation created by the event.

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. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an enterprise's balance sheet are those that exist at the balance sheet date. It is only those 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.

An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law. For example, when environmental damage is caused there may be no obligation to remedy the consequences. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted.

7. Probable Outflow of Resources Embodying Economic Benefits

For a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. For the purpose of this Statement, an outflow of resources or other event is regarded as probable if the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote.

8. Reliable Estimate of the Obligation

The use of estimates is an inherent part of preparing financial statements. Provisions require a greater degree of estimation than most other items, but AS 29 emphasises that it should not be impossible to determine a range of possible outcomes and, from this range, to reach an appropriate conclusion that is sufficiently reliable for the provision to be recognised. AS 29 concludes that the circumstances in which it will not be possible to reach a reliable estimate, will be extremely rare.

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

9. Contingent Liabilities

An enterprise should not recognise a contingent liability but should be disclosed. A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs. 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.

10. Contingent Assets

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

An enterprise should not recognise a contingent asset, since this may result in the recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate. A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority.

11. Measurement -best Estimate

The estimates of outcome and financial effect are determined by the judgment of the management of the enterprise, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The amount of a provision should not be discounted to its present value. The provision is measured before tax; the tax consequences of the provision, and changes in it, are dealt with under AS 22. The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision.

12. Future Events

It is only those obligations arising from past events that exist independently of the enterprise's future actions (i.e. the future conduct of its business) that are recognised as provisions. For example, an enterprise may believe that the cost of cleaning up a site at the end of its life will be reduced by future changes in technology. The amount recognised reflects a reasonable expectation of technically qualified, objective observers, taking account of all available evidence as to the technology that will be available at the time of the clean-up. Thus, it is appropriate to include, for example, expected cost reductions associated with increased experience in applying existing technology or the expected cost of applying existing technology to a larger or more complex clean-up operation than has previously been carried out. However, an enterprise does not anticipate the development of a completely new technology for cleaning up unless it is supported by sufficient objective evidence.

13. Expected Disposal of Assets

Gains on the expected disposal of assets are not taken into account in measuring a provision, even if the expected disposal is closely linked to the event giving rise to the provision. Instead, an enterprise recognises gains on expected disposals of assets at the time specified by the Accounting Standard dealing with the assets concerned.

14. Reimbursements

An, enterprise with a present obligation may be able to seek reimbursement of part or all of the expenditure from another party, for example via:

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

The basis underlying the recognition of a reimbursement is that any asset arising is separate from the related

obligation. Consequently, such a reimbursement should be recognised only when it is virtually certain that it will be received consequent upon the settlement of the obligation.

In most cases, the enterprise will remain liable for the whole of the amount in question so that the enterprise would have to settle the full amount if the third party failed to pay for any reason. In this situation, a provision is recognised for the full amount of the liability, and a separate asset for the expected reimbursement is recognised when it is virtually certain that reimbursement will be received if the enterprise settles the liability.

In some cases, the enterprise will not be liable for the costs in question if the third party fails to pay. In such a case, the enterprise has no liability for those costs and they are not included in the provision.

15. Changes in Provisions

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.

16. Use of Provisions

Only expenditures that relate to the original provision are adjusted against it. Adjusting expenditures against a provision that was originally recognised for another purpose would conceal the impact of two different events.

17. Application of the Recognition and Measurement Rules

Future Operating Losses

Future operating losses do not meet the definition of a liability and the general recognition criteria, therefore provisions should not be recognised for future operating losses.

Restructuring

The following are examples of events that may fall under the definition of restructuring:

a. Sale or termination of a line of business;

b. The closure of business locations in a country or region or the relocation of business activities from one country or region to another;

c. Changes in management structure, for example, eliminating a layer of management; and

d. Fundamental re-organisations that have a material effect on the nature and focus of the enterprise's operations.

A provision for restructuring costs is recognised only when the recognition criteria for provisions. 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. Until there is a binding sale agreement, the enterprise will be able to change its mind and indeed will have to take another course of action if a purchaser cannot be found on acceptable terms.

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.

A restructuring provision does not include such costs as:
a. Retraining or relocating continuing staff;
b. Marketing; or
c. Investment in new systems and distribution networks.

These expenditures relate to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognised on the same basis as if they arose independently of a restructuring. Identifiable future operating losses up to the date of a restructuring are not included in a provision.

As required by paragraph 44, gains on the expected disposal of assets are not taken into account in measuring a restructuring provision, even if the sale of assets is envisaged as part of the restructuring.

18. Disclosure

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.

SMCs are exempt from the disclosure requirements of AS 29
An enterprise should disclose the following for each class of provision:

a. A brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;

b. An indication of the uncertainties about those outflows. Where necessary to provide adequate information, an enterprise should disclose the major assumptions made concerning future events, and

c. The amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

SMCs are exmpt from the disclosure requirements of AS 29
Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:

a. An estimate of its financial effect,
b. An indication of the uncertainties relating to any outflow; and
c. The possibility of any reimbursement.

Illustration 1

At the end of the financial year ending on 31st December, 2011, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

	Probability	Loss (Rs.)
In respect of five cases (Win)	100%	-
Next ten cases (Win)	60%	-
Lose (Low damages)	30%	1,20,000
Lose (High damages)	10%	2,00,000
Remaining five cases		
Win	50%	-
Lose (Low damages)	30%	1,00,000
Lose (High damages)	20%	2,10,000

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.

Solution

According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

i. There is a present obligation arising out of past events but not recognized as provision.

ii. It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

iii. The possibility of an outflow of resources embodying economic benefits is also remote.

iv. The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 60% and for remaining five cases is 50%. As per AS 29, we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 30% of Rs. 1,20,000 + 10% of Rs. 2,00,000
= Rs. 36,000 + Rs. 20,000
= Rs. 56,000

Expected loss in remaining five cases = 30% of Rs. 1,00,000 + 20% of Rs. 2,10,000
= Rs. 30,000 + Rs. 42,000
= Rs. 72,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of Rs. 9,20,000 (Rs. 56,000 x 10 + Rs. 72,000 x 5) as contingent liability.

Illustrations on Accounting Standards

Accounting Standard - 1

Q 1. Company follows the following policy for retirement benefits:

Contribution to pension fund is made based on actuarial valuation at the year-end in respect of employees who have opted for pension scheme. Contribution to the gratuity fund is made based on actuarial valuation at the year-end. Leave encashment is accounted for on Pay AS YOU GO Method.

Solution: As per Para 10(c) of AS-1 (refer point 2.5-3): The "Accrual" is fundamental accounting assumptions, therefore, any accounting policy cannot be contrary to fundamental accounting assumption. Policy followed for leave encashment on basis of 'PAY AS YOU GO' is not in accordance with accrual assumptions. Therefore, the accounting policy as regards leave encashment is not correct; in fact it is contrary to AS-15 "Accounting for retirement benefits".

Q2. Induga Ltd. manufactures a special type of computer. The company has a software division for developing programme with respect to specialized area such as medical imaging. During the year ended 31st March, 2010 the company manufactured a prototype computer to be used for demonstrating the medical imaging software programme and not for sale. The cost of manufacturing of prototype computer was Rs.50lakhs. The amount was included in fixed production overheads of hardware division. Comment.

Solution: Cost of prototype computer, which is manufactured by the Induga Ltd. and is not meant for sale, should no be included in fixed production overheads. Accounting policy is necessary to write off the cost of these prototype computers and same to be disclosed.

Q3. UFC Company is engaged in the business of financial services and is undergoing tight liquidity position, since most of the assets of the company are blocked in various claims/petitions in a Special Court. UFC has accepted Inter Corporate Deposits (ICDs) and, it is making its best efforts to settle the dues. There were claims at varied rates of interest from lenders form the due date of ICDs to the date of repayment. The company has provided interest, as per the terms of the contract till the due date and a note for non-provision of interest from the due date to date of repayment was effected in the financial statements. On account of uncertainties existing regarding the determination of the amount and in the absence of any specific legal obligation at present as per the terms of contracts, the company considers that these claims are in the nature of "claims against the company not acknowledged as debt", and the same has been disclosed by way of a note in the accounts instead of making a provisions in the profit and loss

accounts. Is that correct?

Solution: AS-1 recognises 'prudence' as one of the major considerations governing the selection and application of accounting policies. In view of the uncertainty attached to future events, profit are not anticipated but recognised only when realised though not necessarily in cash. Provision is made 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.

Accrual is one of the fundamental accounting assumptions as per AS-1. Irrespective of the terms of the contract, so long as the principal amount of a loan is not repaid, the lender cannot be replaced in a disadvantageous position by non-payment of interest in respect of overdue amount. From the aforesaid, it is apparent that the company has an obligation on account of the overdue interest. In this situation, the company should provide for the liability (since it is not waived by the lenders) at an amount estimated or on reasonable basis based on facts and circumstances of each case. However, in respect of the overdue interest amounts, which are settled, the liability therefore should be accrued to the extent of amounts settled. Non-provision of the overdue interest liability amounts to violation of accrual basis of accounting.

Q4. Draft the accounting policies to be disclosed in the financial statement for the following items:

a. Revenue recognition - sale of goods
b. Depreciation
c. Impairment of assets
d. Foreign currency translation
e. Inventories

Solution:

a. Sales are recognised when goods are invoiced and despatched to customers and are recorded inclusive of excise duty and net of trade discounts and sales tax.

b. Depreciation is charged on straight line method at the rates specified in Schedule XIV of the Companies Act, 1956 except for the following assets in respect of which depreciation is charged at the rates mentioned below

I. Kutcha Roads	47.50%
ii. Enabling works	20%

c. At each balance sheet date, the company reviews the carrying amounts of its fixed assets to determine whether there is any indication that those assets suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of impairment loss.

   Reversal of impairment loss is recognised immediately as income in the profit and loss account.

d. Income and expenses in foreign currencies are converted at exchange rates prevailing on the date of the transaction. Foreign currency monetary assets and liabilities are translated at the exchange rate prevailing on the

balance sheet date. Forward exchange contracts outstanding at the balance sheet date are stated at fair values and any gains or losses are recognised in the profit and loss account.

e. Inventories are valued as under:

Poultry for livestock breeding	At cost
Raw material and packing materials	At cost or net realisable value, whichever is lower
Work-in-process	At cost or net realisable value, whichever is lower
Finished goods	At cost or net realisable value, whichever is lower
Stores and spares	At cost
By products	At estimated selling price

Cost of finished goods and work in process include cost of conversion and other costs incurred in bringing the inventories to their present location and conditions.

Q5. The gross block of fixed assets are shown at the cost of acquisition, which includes tax, duties (net of MODVAT and set off availed) and other identified direct expenses. Interest on borrowing to finance the fixed assets is not capitalized. Comment

[Answer: Policy appears to be correct]

Accounting Standard - 2

Q1. Induga Ltd. manufacture computer, during the year ended 31st March, 2010 the company manufactured 550 computers, it has the policy of valuing finished stock of good at a standard cost of Rs. 1.8lakhs per computer. The details of the cost are as under:

	(Rs. In Lakhs)
Raw material consumed	400
Direct Labour	250
Variable production overheads	150
Fixed production overheads	290
(Including interest of Rs. 100)	

Compute the value of cost per computer for the purpose of closing stock.

Solution: As per AS-2 (Revised) (refer point 3.6), on valuation of Inventories, finished stock of goods should be valued on the basis of absorption costing, While absorbing fixed production overheads the normal production capacity is considered. In this case finished stock has been valued at a standard cost of Rs.1.8 lakhs per computer which incidentally synchronizes with the value computed on the basis of absorption costing as under:

		(Rs. In lakhs)
Materials		400
Direct Labour		250
Variable production overheads		150
Fixed production overheads	290	
Less: Interest	100	190
Total Cost		990

Number of computers produced 550
(Assumed to be normal production)

Cost per computer 990/550=Rs. 1.80 lakhs

Policy of the company to value closing stock is not as per AS-2. As per para 18 of AS-2, (refer point 3.9-1) the techniques of standard cost method may be used for convenience if the result approximates to the actual cost and standard cost is regularly reviewed if necessary. In the instant case, the cost of inventory can be conveniently calculated as per absorption costing. Therefore, there is no reason that standard costing method should be adopted.

Q2. Raw material was purchased at Rs. 100 per kg. Price of raw material is on the decline. The finished goods in which the raw material is incorporated are expected to be sold at below cost.10,000 kgs. of raw material is in stock at the year-end. Replacement cost is Rs. 80 per kg. How will you value the inventory?

Solution: As per para 24 of AS-2 (refer point 3.11), on valuation of inventories, material and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of

materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the material may be the best available measure of their net realisable value.

Hence in this case, the stock of 10000 kgs. of raw material will be valued at Rs. 80 per kg. The finished goods, if on stock, should be valued at cost or net realisable value, whichever is lower.

Q3. How will you value the inventory per kg. of finished goods consisted of:

Material cost	Rs. 100 per kg.
Direct Labour cost	Rs. 20 per kg.
Direct variable production overhead	Rs. 10 per kg.

Fixed production charges for the year on normal capacity of one lakh kgs. is Rs. 10 lakhs. 2000 kgs. of finished goods are on stock at the year-end.

Solution: In accordance with paras 8 & 9 of AS-2, (refer point 3.6) the costs of conversion include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. The allocation of fixed production overheads for the purpose of their inclusion in the cost of conversion is based on the normal capacity of the production facilities. Thus, cost per kg. of finished goods can be computed as follows:

	Rs.	
Material cost		100
Direct Labour cost	20	
Direct variable production overhead	10	
Fixed production overhead (Rs. 10,00,000/100000)	10	
		140

Thus, the value of 2000 kgs. of finished goods on stock at the year-end will be Rs. 2,80,000 (2000 kgs. X Rs.140)

Q4. The Company sells IMFL and beer to the customers, some of the customers consumed the beer in the bars run by it. While leaving the bar, the consumers left the empty bottles in the bars and the company takes the possession of these empty bottles. These empty bottles are disposed of by the company. The company has laid down detailed procedures for the maintenance of the records, tenders to be called for the disposal of empty bottles etc.

Keep in view the above-

a. Whether the stock of empty bottles is an asset of the company.

b. If so, whether the stock of empty bottles existing as on the date of the balance sheet is to be considered as inventories of the company.

c. If the answer to (b) above is positive, whether the stock of empty bottles existing as on the date of the balance sheet is to be valued at net realisable value and considered as income to be shown in the profit and loss account or is to be shown in the profit and loss account or is to be considered as a stock suspense account on the liabilities

side of the balance sheet if the cost of empty bottles is NIL.

Solution:

a. The stock of empty bottles is an asset of the company being a resource controlled by the company as a result of past events from which future economic benefits are expected to flow to it.

b. The stock of empty bottles existing at the balance sheet date is the inventory of the company.

c. The stock of empty bottles should be valued at the lower of cost and net realisable value. The same is not considered as income. In case, the cost of empty bottles is Nil, the total stock of bottles should be reflected at the nominal value of Re. 1 in balance sheet.

Accounting Standard - 3

Q1. The following additional information is also relevant for the preparation of the statement of cash flows (figures are in Rs.'000).

- An amount of 250 was raised from the issue of share capital and a further 250 was raised from long-term borrowings.
- Interest expense was 400 of which 170 was paid during the period. 100relating to interest expense of the prior period was also paid during the period.
- Dividends paid were 1,200.
- Tax deducted at source on dividends received (included in the tax expense of 300 for the year) amounted to 40.
- During the period, the enterprise acquired fixed assets for 350. The payment was made in cash.

Balance Sheet as at 31-12-2010

		(Rs.'000)
Assets	**2010**	**2009**
Cash on hand and balances with banks	200	25
Short-term investments	670	135
Sundry Debtors	1,700	1,200
Interest receivable	100	-
Inventories	900	1,950
Long-term Investments	2,500	2,500
Fixed assets at cost	2,180	1,910
Accumulated depreciation	(1,450)	(1,060)
Fixed assets (net)	730	850
	6,800	6,660
Liabilities		
Sundry Creditors	50	1,890
Interest payable	230	100
Income-tax payable	400	1,000
Long-term debt	1,110	1,040
Total Liabilities	1,890	4,030
Shareholders' funds		
Share Capital	1,500	1,250
Reserves	3,410	1,380
Total shareholders' funds	4,910	2,630
Total Liabilities and shareholders' funds	6,800	6,660

Statement of Profit and Loss for the period ended 31-12-2010

	(Rs. '000)
Sales	30,650
Cost of sales	(26,000)
Gross profit	4,650
Depreciation	(450)
Administrative and selling expenses	(910)
Interest expense	(400)
Interest income	300
Dividend income	200
Foreign exchange loss	(40)
Net profit before taxation and extraordinary item	3,350
Extraordinary item—	
Insurance proceeds from earthquake disaster settlement	180
Net profit after extraordinary item	3,530
Income tax	300
Net Profit	3,230

- Plant with original cost of 80 and accumulated depreciation of 60 was sold for 20.
- Foreign exchange loss of 40 represents the reduction in the carrying amount of a short-term investment in foreign currency designated bonds arising out of a change in exchange rate between the date of acquisition of the investment and the balance sheet date.
- Sundry debtors and sundry creditors include amounts relating to credit sales and credit purchases only.

Note 1: Notes to the Cash Flow Statement (Direct & Indirect method)-Cash and Cash Equivalents-Cash and cash equivalents consist of cash in hand and balances with banks and investments in money market instruments. Cash and cash equivalents included in the cash flow statement comprise the following balance sheet amounts.

Cash in hand and balances with banks	200	25
Short-term investments	670	135
Cash and cash equivalents	870	160
Effect of exchange rate changes	40	-
Cash and cash equivalents as restated	910	160

Cash and cash equivalents at the end of the period include deposits with banks of Rs. 100 held by a foreign branch, which are not freely remissible to the company because of currency exchange restrictions.

The company has withdrawn borrowing facilities of 2000 of which 700 may be used only for future expansion.

1. Total tax paid during the year (including tax deducted at sources on dividend received) amounted to 900.

Solution :

Direct Method Cash Flow Satement

		(Rs.'000)
Cash flows from operating activities		2010
Cash receipts from customer	30,150	
Cash paid to suppliers and employees	(27,600)	
Cash generated from operations	2550	
Income-tax paid	(860)	
Cash flow before extraordinary items	1690	
Proceeds from earthquake disaster settlement	180	
Net cash from operating activities		1870
Purchase of fixed assets	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividend received	160	
Net cash from investing activities		30
Cash flows from financing of share activities		
Proceeds from issuance of share capital	250	
Proceeds from long-term borrowings	250	
Repayments of long-term borrowings	(180)	
Interest paid	(270)	
Dividend paid	(1200)	
Net cash used in financing activities		(1150)
Net increase in cash and cash equivalents		750
Cash and cash equivalents at beginning period (see Note 1)		160
Cash and cash equivalents at end of period (see Note 1)		910

Indirect Method Cash Flow Statement

	(Rs.'000)
	2010
Cash flow from operating activities	
Net profit before taxation and extraordinary items	3350
Adjustment for:	
Depreciation	450
Foreign exchange loss	40
Interest income	(300)
Dividend income	(200)
Interest expense	400
Operating profit before working capital changes	3,740
Increase in sundry debtors	(500)
Decrease in inventories	1,050
Decrease in sundry creditors	(1,740)
Cash generated from operations	2,550

Income-tax paid	(860)	
Cash flow before extraordinary item	1,690	
Proceeds from earthquake disaster settlement	180	
Net cash from operating activities		1,870
Cash flows from investing activities		
Purchase of fixed assets	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividends received	160	
Net cash from investing activities		30
Cash flows from financing activities		
Proceeds from issuance of share capital	250	
Proceeds from long-term borrowings	250	
Repayment of long-term borrowings	(180)	
Interest paid	(270)	
Dividends paid	(1,200)	
Net cash used in financing activities		(1,150)
Net increase in cash and cash equivalents		750
Cash and cash equivalents at beginning of period (see note 1)		160
Cash and cash equivalents at end of period (see note 1)		910

Alternative Presentation (Indirect Method)

As an alter native, in an indirect method cash flow statement, operating profit before working capital changes is sometimes presented as follows:

Revenues excluding investment income	30,650	
Operating expense excluding depreciation	(26,910)	
Operating profit before working capital changes		3,740

Working Notes

The working notes given below do not form part of the cash flow statement and, accordingly, need not be published. The purpose of these working notes is merely to assist in understanding the manner in which various figures in the cash flow statement have derived.

(Figures are in Rs.'000)

Cash receipts from customers

Sales	30,650
Add: Sundry debtors at the beginning of the year	1,200
	31,850
Less: Sundry debtors at the end of the year	1,700
	30,150

Cash paid to suppliers and employees

Cost of sales	26,000
Administrative & selling-expenses	910

		26,910
Add: Sundry creditors at the beginning of the year	1,890	
Inventories at the end of the year	900	2,790
		29,700
Less: Sundry creditors at the end of the year	150	
Inventories at the beginning of the year	1,950	2,100
		27,600

Income-tax paid (including tax deducted at source from dividends received)

Income-tax expense for the year (including tax deducted at source from dividends received)	300
Add: Income-tax liability at the beginning of the year	1,000
	1,300
Less: Income-tax liability at the end of the year	400
	900

Out of 900, tax deducted at source on dividends received (amounting to 40) is included in cash flows from investing activities and the balance of 860 is included in cash flows from operating activities.

Repayment of long-term borrowings

Long –term debt at the beginning of the year	1,040
Add: Long-term borrowings made during the year	250
	1,290
Less: Long-term borrowings at the end of the year	1,110
	180

Interest paid

Interest expense for the year	400
Add: Interest payable at the beginning of the year	100
	500
Less: Interest payable at the end of the year	230
	270

Format of
Cash Flow Statement for a Financial Enterprise

Cash flows from operating activities		
Interest and commission receipts		-
Interest payments	-	
Recoveries on loans previously written off	-	
Cash payments to employees and suppliers	-	
Operating profit before changes in operating assets	-	
(Increase) decrease in operating assets:		
Short-term funds	-	
Deposits held for regulatory or monetary control purposes		-
Funds advanced to customers	-	

Net increase in credits card receivables	-			
Other short-term securities	-			
Increase (decrease) in operating liabilities:				
Deposits from customers	-			
Certificates of deposit	-			
Net cash from operating activities before income-tax	-			
Income-taxes paid	-			
Net cash from operating activities	-		-	
Cash flows from investing activities				
Dividends received	-			
Interest received	-			
Proceeds from sales of permanent investments	-			
Purchase of permanent investments	-			
Purchase of fixed assets		-		
Net cash from investing activities		-		-
Cash flows from financing activities				
Issue of shares	-			
Repayment of long-term borrowings	-			
Net decrease in other borrowings	-			
Dividends paid	-			
Net cash from financing activities				-
Net increase/decrease in cash and cash equivalents			-	
Cash and cash equivalents at beginning of period				-
Cash and cash equivalents at end of period			-	

Q2. From the following Summary Cash Account of Y Ltd. prepare Cash Flow Statement for the year ended 31st March, 2010 in accordance with AS-3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31-3-2010

	Rs. '000		Rs. '000
Balance on 1-4-2009	50	Payment to suppliers	2,000
Issue of Equity shares	300	Purchase of Fixed Assets	200
Receipts from customers	2,800	Overhead Expenses	200
Sale of Fixed Assets	100	Wages and Salaries	100
		Taxation	250
		Dividend	50
		Repayment of bank loan	300
		Balance on 31-3-2010	150
	3,250		3,250

Ans: Cash from operating - Rs. 250, investing - (100), financing (50)

Q3. The information of cash flow generated by two companies A Ltd. and B Ltd. belonging to same industry is as

follows:

F.Y. 2009-10

Cash flow Statement

	A Ltd.	B Ltd.
	Rs.	Rs.
Opening balance	18,000	20,000
Cash flow from operating Activities		
Receipts from sale of goods	5,000	30,000
Cash from investing activities		
Sale of fixed assets	20,000	3,000
Cash from financing activities		
Amount borrowed	20,000	2,000
Closing balance	63,000	55,000

Company A claims that its cash generating ability is better than that of B Ltd. Do you agree? Comment on the cash generating ability of both companies.

[Ans: No, B Company cash generating capacity is better]

Q4. A Ltd. paid income-tax on Capital Gains resulting from disposal of capital assets and showed it as a deduction from cash flow from operating activities. Is this treatment is in compliance with AS-3 (Revised)? Suggest correct treatment of Income-tax.

[Ans: No, Should be shown with investing activities]

Q5. A Ltd. a financial services company, made a total loan of Rs. 1 crore during Financial Year 2009-10. How will you classify such loan in the cash flow statement of the company as per AS-3?

[Ans: Operating activities]

Q6. J.M. Harding, a stock broking firm, received Rs. 1.50 lakhs as premium for forward contracts entered for purchase of equity shares. How will you classify this amount in the Cash Flow Statement of the firm?

a. Operating Activities
b. Investing Activities
c. Financing Activities
d. None of the above

[Ans: (a)]

Accounting Standard - 4

Q1. NDA Limited closed its accounting year on 30-6-2010 and the accounts for that period were considered and approved by the board of directors on 20th August, 2010. The company was engaged in laying pipeline for an oil company, deep beneath the earth. While doing the boring work on 1-9-2010 it had met a rocky surface for which it was estimated that there would be extra cost to the tune of Rs. 80 lakhs. You are required to state with reasons, how it would be dealt with in the financial statements for the year ended 30-6-2010.

Solution: Para 3.2 of AS-4 (refer point 5.7), on 'Contingencies and Events Occurring after the Balance Sheet Date' defines' 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 financial statements are approved by the Board of Directors'.

In this case the incidence, which was expected to push cost, became evident after the date of approval of the accounts. So that was not an 'event occurring after the balance sheet date' as per AS-4. However, this may be mentioned in the Director's Report.

Q2. A company entered into an agreement to sell its immovable property included in the Balance Sheet at Rs. 5 lakhs to another company for Rs. 20 lakhs. The agreement to sell was concluded on 31-1-2010 and the sale deed was registered on 30-4-2010. How this will be treated in Balance Sheet as on 31-3-2010.

Solution: As per para 13 of AS-4 (refer point No. 5.8) Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amount relating to conditions existing at the balance sheet date. In this case sale of immovable property was concluded before, approval by the Board. This is clearly an event occurring after the balance sheet date. Agreement to sell was entered into before the balance sheet date. Registration of the sale deed simply provides additional information relating to the condition existing at the balance sheet date. So adjustments to assets are necessary and Assets will be derecognised in the Balance Sheet as on 31-3-2010.

Q3. Advise to B co. Ltd. about the treatment of the following in the final statement of accounts for the year ended 31st March, 2010.

On 15th April, 2010, due to destruction of the factory by fire (fire took place on 27th March, 2010), one of the company's debtors, declared himself insolvent. He owed Rs. 1,17,000 to B Co. Ltd.

Solution: As per para 13 of AS-4 (refer point no. 5.8) Adjustment of assets and liabilities is to be made if event relates to the condition existing on the balance sheet date and provides additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. In this case the fire took place on 27th march, 2010 before the date of balance sheet and debtors are declared insolvent on 15th April, 2010, the event of 15the April, 2010 only provides the additional evidence to estimate the amount of loss.
Accordingly, adequate provision for bad debts should be created to cover the loss arising out of insolvency for the year ended 31st March, 2010.

Q4. While preparing its final accounts for the ended 31st March, 2010 a company made a provision for bad debts @ 5% of its total debtors. In the last week of February, 2010 a debtor for Rs. 2 lakhs had suffered heavy loss due to earthquake; the loss was not covered by any insurance policy. In April 2010 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2010?

Solution: Yes, company should provide for full loss arising out of insolvency of the debtors for the year ended 31-3-2010.

As per AS-4 "Events occurring after the balance sheet date" but before the date of finalization of the balance sheet, the circumstances of which were existing on the balance sheet date must be adjusted in accounts. In the instant case, circumstances were existing on the balance sheet date and event of April (declaration of insolvency) only confirm the circumstances existing on the date of balance sheet i.e. 31-3-2010 hence it is adjustable event.

Q5. One of the manufacturing units of B Ltd. wherein equal to 50% of the total assets was destroyed in fire for which there was no insurance cover. The chief accountant of the company contests that the destruction of unit took place only after the date of the Balance sheet and therefore there was no need to make a disclosure of loss in the annual account as at Balance Sheet date. Whether contention of chief accountant was correct.

[Ans: No, disclosure by way of note to accounts]

Accounting Standard - 5

Q1. At December 31, 2010, Matson Inc. Was holding long-lived assets, which it intended to sell. The company appropriately recognized a loss in 2010 related to these assets. On Matson Inc.'s income statement for the year ended December 31, 2010 this loss should be reported as an

a. Extraordinary item.
b. Component of income from continuing operation before income-taxes.
c. Separate component of selling or general and administrative expenses, disclosed net of tax benefit.
d. Component of the gain (loss) from sale of discontinued operation, disclosed net of income-taxes.

Solution : As per AS-5 (refer point 6.2-1) losses associated with long-lived assets, which are to be disposed of, are to be reported as a component of income from continuing operations before income-taxes for entities preparing income statement. Therefore, answer (b) is correct. Answer (a) is incorrect because losses on long-lived assets to be disposed of are neither unusual nor infrequent occurrences. Answer (c) is incorrect because these losses are not part of selling or general and administrative expenses and they are not disclosed net of tax, answer (d) is incorrect, because discontinued operation result from disposal of a business, not the disposal of long-lived assets held for resale.

Q2. The company has to pay delayed cotton clearing charges over and above the negotiated price for taking delayed delivery of cotton from the Supplier's Godown. Up to 2008-09, the company has regularly included such charges in the valuation of closing stock. This being in the nature of interest the company has decided to exclude it from closing stock valuation for the year 2009-10. This would result into decrease in profit by Rs. 7.60 lakhs. Comment.

Solution : AS-5(refer point 6.5) states that a change in an accounting policy should be made only if the adoption of a different accounting policy is required by statute or for compliance with and accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of an enterprise. Therefore, the change in the method of stock recommendations of AS-2 and would result in more appropriate preparation of the financial statements. As per AS-2, this accounting policy adopted for valuation of inventories including the cost formulae used should be disclosed in the financial statements.

Also, appropriate disclosure of the change and the amount by which any item in the financial statements is affected by such change is necessary as per AS-1, AS-2 and AS-5. Therefore, the under mentioned note should be given in the Annual Accounts.

"In compliance with the Accounting Standard issued by the ICAI, delayed cotton clearing charges which are in the nature of interest have been excluded from the valuation of closing stock unlike preceding year. Had the company continued the accounting practice followed earlier, the value of closing stock as well as profit before tax for the year would have been higher by Rs. 7.60 lakhs".

Q3. Fuel surcharge is billed by the State Electricity Board at Provisional Rate. Final bill for fuel surcharges of Rs. 5.30 lakhs for the period October, 2005 to September, 2009 has been received and paid in February, 2010. How this should be dealt in accounts for year 2009-10

Solution: It seems as a result of errors or omission in the preparation of financial statements of prior period i.e. 2005

to 2009. This material charge has arisen in the current period i,e. year ended 31st March, 2010, therefore it should be treated as prior period item as per para 16 of AS-5(refer point 6.3) and as such should be separately disclosed as per para 15 of AS-5 (refer point 6.3-1) so that impact of this item on current profit can be known. It should be further noted that the item is not an extraordinary item as per para 10 of AS-5 (refer point 6.2-2) as fuel surcharge expense arises from ordinary course of business.

Q4. U.P. Rajya Setu Nigam Ltd. was awarded a contract of construction of a bridge for Rs. 100 crores on 1-6-2006. Total contract cost estimated was Rs. 80 crores. The position of the contract on 31-3-2009 and 31-3-2010 was under:

	As on 31-3-2009	As on 31-3-2010
Contract price	100	100
Contract cost incurred up to date	25	95(100% complete)
Estimate contract cost of Completion	60	Nil

While closing books of account on 31-3-2010, the chief accountant treated excess cost of Rs. 10 crores incurred as against estimated of Rs. (25+60)=85 crores as on 31-3-2009 as mistakes in estimation of cost, hence categorized Rs. 10crores (95-85) as prior expenses, Comment.

Solution:

Cost originally estimated by U.P. Rajya Setu Nigam Ltd.	Rs. 85 crores
Excess Cost incurred	Rs. 10 crores
Treatment given by the company	Prior period item

As clearly provided in AS-5, a change in estimate is neither a prior period item nor an extraordinary item. Hence, the treatment given by the company is incorrect.

Q5. State how you will deal with the following matter in the accounts of U Ltd. for the year ended 31st March, 2010 with reference to Accounting standard:

"The company finds that the stock sheets of 31-3-2009 did not; no include two pages containing details of inventory worth Rs. 14.5 lakhs."

Solution : As per AS-5 an item of expenses or income arises in current period as a result of omission or commission in the preparation of financial statements of one or more prior is prior period item.

In this case stock sheet of 31-3-2009 (prior year) did not include two pages containing details of inventory worth Rs. 14.5 lakhs which is the omission, and this omission was detected in current period i.e. 31-3-2010. Therefore, it is a prior period item. Entry to be passed is as under:

Opening inventory A/c	Dr. Rs. 14.5 lakhs	
To Prior Period Income		Rs. 14.5 lakhs

Accounting Standard - 6

Q1. A Plant was depreciated under two different methods as under:-

	Straight Line Method	Written Down Value
1st year	3.90	10.69
2nd year	3.90	7.90
3rd year	3.90	5.84
4th year	3.90	4.32
	15.60	28.75
5th year	3.90	3.19

Required:-

a. If the company followed WDV for first four years and decides to switch over to SLM, what would be the amount of resultant surplus/deficiency?

b. If the company followed SLM for first four years and decides to switch over to WDV, what would be amount of resultant surplus/deficiency?

Solution: As per para 21 of AS-6 (refer points 7.7 & 7.7-1) when a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In case the change in the method results in deficiency in depreciation in respect of past year, the deficiency should be charged in the statement of profit and loss. In case the change in the method results in surplus, the surplus should be credited to statement of profit and loss.

a. Surplus of Rs.13.15 will be written back to profit and loss account.

b. Deficiency of 13.15 should be charged to profit and loss account.

Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

Q2. The Company's plant and machinery was Rs. 3,000 lakhs as on 1-4-2009. It provided depreciation at 15% per annum under WDV method. However it noticed that about Rs. 500 lakhs worth of imported asset, which is component of above plant and machinery acquired on 1-4-2009, would be obsolete in 2 years. Company wants to write off this asset over 2 years. Can company do so? Give comments.

Solution : AS per para 34 of AS-6 (refer point 7.10), where and addition or extension retain a separate identity and is capable of being used after the existing asset is disposed of, depreciation should be provided independently on the basis of an estimate of its own useful life. As it appear that imported asset of Rs. 500lakhs, which is component of plant and machinery, is having independent useful life. Therefore, the company's policy to write off over two years is correct.

Q3. Gammon (India) Ltd. Uses horses to transport material from one place to another place on hilly area where construction activity is going on. It purchases horses worth Rs. 80,000 for transporting material on 1-4-2009. Useful life of horses was estimated 5 years, therefore company decided to write off depreciation on horses as per SLM over 5 years. Comment.

Solution : The treatment followed by the company is not correct as per AS-6 Para 1(v) (refer point 7.3) Depreciation Accounting is not applicable to live Stock.

Q4. NDA Ltd. purchased certain plant and machinery of Rs. 40 lakhs. 20% of the cost net of CENVAT credit is the subsidy component to be realised from a state Government for establishing industry in a backward district. Cost Rs. 40 lakhs include excise Rs. 5 lakhs against which CENVAT credit can be claimed. Compute depreciable amount.

Solution: In this case, it is first necessary to determine the historical cost of the plant and machinery. This is shown as follows:

	(RS. in lakhs)
Purchase price	40
Less: Specified duty against which CENVAT credit is available	5
Originally cost of plant and machinery for accounting purpose	35
Less: Subsidy	7
Depreciable amount	28

Alternatively, the original cost of the plant and machinery can be taken at Rs. 35 lakhs and a sum of Rs. 7 lakhs can be transferred to deferred income account by way of a "subsidy reserve". While CENVAT credit can be presently availed of only in two annual instalments of 50% each, that portion of unavailed CENVAT credit is also required to be reduced form cost.

Depreciable amount would be as under:

(a) Where the entire subsidy is adjusted against cost Rs. 28 lakhs

(b) Where the subsidy is held as deferred income Rs. 35 lakhs

Q5: An item of plant was purchased on 1-4-2008 for Rs. 2,00,000. The WDV depreciation rate applicable to the plant was 15%. The written down value of the plant as on 31-3-2010 was Rs. 1,44,500. On 1-4-2010, the enterprise decided to change the method from written down value to straight line. The enterprise decided to write off the book value of Rs. 1,44,500 over the remaining useful life of plant i.e. 15 years (Out of the total useful life of 17 years, 2 years have already elapsed)

Comment whether the accounting treatment is correct. If not, give the correct accounting treatment with reasons.

Ans. : No, recalculate depreciation and surplus credited to Profit and Loss A/c of Rs. 31,970 (cr.)

Q6: A company has acquired a Plant and Machinery at 6.5 lakhs on instalment basis from a dealer (The cash down price is Rs. 6 lakhs). During the year, company paid Rs. 50,000 as down payment and Rs. 1.5 lakhs as the instalment for the year. The company provided the depreciation @ 15% on Rs.2 lakhs Comment, whether the depreciation on Rs. 2 lakhs is correct with reasons.

Ans.: No.

Accounting Standard - 9

Q1. The board of directors decided on 31-3-2010 to increase the sale price of certain items retrospectively form 1st January, 2010.

In view of this price revision with effect from 1st January, 2010, the company has to receive Rs. 25 lakhs from its customers in respect of sales made form 1st January, 2010 to 31st March, 2010 and the Accountant cannot make up his mind whether to include Rs. 25 lakhs in the sales for 2009-10. Suggest.

Solution: Price revision effected during the current accounting period 2009-10. As a result, the company stands to receive Rs. 25 lakhs from its customers in respect of sales made from 1st January, 2010 to 31st March, 2010. If the company is able to assess the ultimate collection with reasonable certainty, then additional revenue arising out of the said price revision may be recognized in 2009-10 vide para 10 of AS-9 (refer point 9.2).

Q2. Advise to Induga Ltd. about the treatment of the following in the final statement of accounts for the year ended on 31st March, 2010.

A claim lodged with the Railways in March 2007 for loss of goods of Rs. 2,00,000
had been passed for payment in March 2010 for Rs. 1,50,000. No entry was passed in the books of the company, when the claim was lodged.

Solution : Para 9.2 of AS-9 (refer point 9.4) on recognition states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. Para 9.5 of AS-9 (refer point 9.4) state that when recognition of revenue is postponed due to effect of uncertainties, it is considered as revenue of the period in which it is properly recognized. In this case it may be assumed that ability of claim was not certain in the earlier periods. This is supposed from the fact that only Rs.1,50,000 were collected against a claim of Rs, 2,00,000. So this transaction cannot be taken as a prior period item.

In the light of AS-5, (refer point 6.2-1) it will not be treated as extraordinary item. However, Para 12 of AS-5 states that when item of income and expense within profit and loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of enterprises for the period, the nature and amount of such item should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately as per Para 12 of AS-5 (revised).

Q3. The NDA Ltd. has recognized Rs. 7.5 lakhs on accrual basis income from dividend on securities and units of mutual funds of face value of Rs. 50 lakhs held by it as at the end of the financial year 31st March, 2010. The dividends on the securities and mutual funds were declared at the rate of 15% on 15th June, 2010. The dividend was proposed on 10-4-2010 by the declaring company. Whether the treatment is as per the relevant accounting standard?

Solution : No, the treatment is not as per accounting standard-9. As per Para 13 of AS-9(refer point 9.8) dividend is recognized in the books of investor when the right to receive is established. In this case right to receive is established on 15-6-2010, hence dividend is deemed to be accrued on 15-6-2010 and, therefore, the dividend income should be recognized by NDA Ltd. during the year 2010-11.

Q4. Induga Ltd, used certain resources of NDA Ltd. In return NDA Ltd. received Rs. 10lakhs and Rs. 15 lakhs as interest and royalties respectively from Induga Ltd. during the year 2010-11. You are required to state whether and on what basis these revenues can be recognized by NDA Ltd.

Solution : As per Para 13 of AS-9 (refer points 9.6 & 9.7) on Revenue Recognition, revenue arising from the use by other of enterprise resources yielding interest and royalties should only be recognized when no significant uncertainty as to its measurability or collect ability exists. These revenues are recognized on following bases:

i. **Interest:** On a time proportion basis taking into account the amount outstanding and the rate applicable.

ii. **Royalties:** On an accrual basis in accordance with the terms of the relevant agreement.

Here in the case interest should be recognized in the year to which it pertains, not in the year in which it is received. It is not clear from the question whether interest of Rs. 10 lakhs pertains to 2010-11 or it pertains to earlier year and received in 2010-11. Same is the case with royalty. If both the interest and royalty accrue in 2010-11, it should be recognized in this year only.

Q5. Media advertising obtained advertisement right for one day world cup cricket tournament to be held in May/June 2010 for Rs. 250 lakhs. By 31st March, 2010, they paid Rs. 150 lakhs to secure these advertisement rights. The balance Rs. 100 lakhs was paid in April 2010.

By 31st March, 2010, they processed advertisement for 70% of the available time for Rs.350 lakhs. The advertiser paid 60% of amount by that date. The balance 40% was received in April 2010.

The advertisement for balance 30% time was procured in April 2010 for Rs. 150 lakhs.

The advertiser paid the full amount while booking the advertisement. 25% of the advertisement time is expected to be available in May 2010 and balance 75% in June 2010.

Calculate the profit/loss for the month of April, May, June 2010.

Solution : As per Para 12 of AS-9 (refer point 9.5-3). In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the service. Further, appendix to AS-9 states that revenue from advertising should be recognized when the service is completed. In this case the service as regards advertisement is deemed to be completed when the related advertisement appears before the public.

As the 25% of the advertisement appeared in May 2010 and 75% in June 2010, therefore the revenue with 250 lakhs [i.e, (350+150) - (150+100)], should be apportioned in 25% and 75% ratio which will be 62.5 lakhs to may 2010 and 187.5 in June 2010.

Accounting Standard - 10

Q1. On 1-4-2010 Induga Ltd. had sold some of its fixed assets for Rs. 100 lakhs written down value Rs. 250 lakhs, these assets were revalued earlier. As on 1-4-2010 the revaluation reserve corresponding to these assets stood at Rs. 200 lakhs. The profit on sale of property Rs. 200 lakhs. Shown in the profit and loss statement represented the transfer of this amount. Loss on sale of asset was included in the cost of goods sold. Comment.

Solution : As per Para 32 of AS-10 (refer point 10.8-2), on accounting for fixed assets. On disposal of a previously revalued item of fixed assets, the difference between net disposal proceeds and the net book value is normally charged or credited to the profit and loss statement except that to the extent such a loss is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilized, it is charged directly to that account. The amount standing in revaluation reserve following the retirement or disposal of an asset, which relates to that asset, may be transferred to general reserve. Accordingly, the following journal entries are to be passed

		(Rs. In lakhs)	
Profit on sale of property	**Dr.**	**200**	
To Cost of goods sold			**150**
To General Reserve			**50**

Q2. AD Softex (India) Ltd. expects that a plant has become useless which is appearing in the books at Rs. 10 lakhs gross value. The company charges SLM depreciation on a period of 10 years estimated life and estimated scrap value of 3%. At the end of 7th year the plant has been assessed as useless. Its estimated net realisable value is Rs. 3,10,000. Determine the loss/gain on retirement of the fixed assets.

Solution : Cost of the plant Rs. 10,00,000

Estimated realisable value Rs. 30,000

Depreciable amount Rs. 9,70,000

Depreciation per year Rs. 97,000

Written down value at the end of 7th year = 10,00,000-(97,000X7) =Rs. 3,21,000

As per Para 14.2 of AS-10 (refer point 10.8), items of fixed assets that have been retired from active use and are held for disposal are stated at the lower of their net book value and net realisable value and are shown separately in the financial statements. Any expected loss is recognized immediately in the profit and loss statement. Accordingly, the loss of Rs. 11,000 (321000-310000) to be shown in the profit and loss account and asset of Rs. 3,10,000 to be shown in the balance sheet separately.

Q3. A company has purchased plant and machinery in the year 2006-07 for Rs. 45 lakhs. A balance of Rs. 5 lakhs is still payable to the suppliers for the same. The supplier waived off the balance amount during the financial year 2009-10. The company treated it as income and credited to profit and loss account during 2009-10.

Whether accounting treatment of the company is correct. If not, state with reasons.

Solution : As per Para 9.1 of AS-10 (refer point 10.3) the cost of fixed assets may undergo changes subsequent to its acquisition or construction on account of exchange fluctuation, price adjustments, changes in duties or similar factors. Considering Para 9.1 the treatment done by the company is not correct. Rs. 5 lakhs should be deducted from the cost of fixed assets.

Q4. NDA Co. purchased a machine costing Rs. 1,25,000 for its manufacturing operation and paid shipping costs of Rs. 20,000. NDA spent and additional amount of Rs. 10,000 for testing and preparing the machine for use. What amount should NDA record as the cost of the machine?

Solution : As per para 20 of AS-10, (refer point 10.3), the cost of fixed asset should comprise its purchase price and any attributable cost of bringing the asset to its working condition for its intended use. In this case the cost of machinery includes all expenditures incurred in acquiring the asset and preparing it for use. Cost includes the purchase price, freight and handling charges, insurance cost on the machine while in transit, cost of special foundations, and costs of assembling, installation and testing. Therefore the cost to be recorded is Rs. 1,55,000 (Rs. 1,25,000+Rs. 20,000+Rs. 10,000)

Q5. On March 31, 2010, Winn Company traded in an old machine having a carrying amount of Rs.16,800, and paid cash difference of Rs. 6,000 for a new machine having a total cash price of Rs. 20,500. On March 31, 2010, what amount of loss should Winn Company recognize on this exchange?

Solution : As per Para 22 of AS-10, (refer point 10.3-3) – when a fixed asset is acquired in exchange or in part exchange for another asset, the cost of the asset acquired should be recorded either at fair market value or at the net book value of the asset given up, adjusted for any balancing payment or receipt, of cash or other consideration. The cash price of the new machine represents its fair market value (FMV). The FMV of the old machine can be determined by subtracting the cash portion of the purchase price (Rs. 6,000) from the total cost of the new machine. Rs. 20,500-Rs. 6,000 = Rs. 14,500. Since the book value of the machine (Rs. 16,800) exceeds its FMV on the date of the trade in (Rs. 14,500), the difference of Rs. 2,300 must be recognized as a loss, however, if the FMV of the old machine had exceeded its book value, the gain would not be recognized.

Accounting Standard - 11

Q1.	Exchange Rate
Goods purchased on 24-2-2009 of US $ 10000	Rs. 46.60
Exchange rate on 31-3-2009	Rs. 47.00
Date of actual payment 5-6-2010	Rs. 47.50

Calculate the loss/gain for the financial year 2008-09 and 2010-11.

Solution: As per AS-11 all foreign currency transactions should be recorded by applying the exchange rate at the date of transaction. Therefore goods purchased on 24-2-2009 and corresponding creditor would be recorded at Rs. 46.60 = US $ 1, i.e.

10,000 X 46.60 = Rs. 466,000

As per AS-11 at the balance sheet date all monetary items should be reported using the closing rate therefore creditors of US $ 10000 outstanding on 31-3-2010 will be reported.

10,000 X 47.00 = Rs. 470,000

Exchange loss (470,000 – 466,000) should be debited in profit and loss account for 2008-09.

As per AS-11 exchange difference on settlement on monetary items should be transferred to profit and loss account as gain or loss therefore 10000 X 47.50 =475,000 – 470,000 = Rs. 5000 will be debited to profit or loss for the year 2010-11.

Q2. NDA Ltd. purchased fixed assets for US $ 50 lakhs costing Rs. 1825 lakhs on 1-4-2006 and the same was fully financed by the foreign currency loan [i.e. US Dollars] repayment in five equal instalments annually. [Exchange rate at the time of purchase was 1 US Dollar = Rs. 36.50]. As on 31-3-2007 the first instalment was paid when 1 US Dollar fetched Rs. 41.50. The entire loss on exchange was included in cost of goods sold etc. NDA Ltd. normally provides depreciation on fixed assets at 20% on WDV basis.

Solution : In this case AS-11 (pre-revised - 1994) shall be applicable on Accounting for effects of changes in Foreign Exchange Rates, as the transaction in foreign currency has been entered into by the reporting enterprises before 1-4-2007. Exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, should be adjusted in the carrying amount of the respective fixed assets. The carrying amount of such fixed assets to the extent not already so adjusted or otherwise accounted for, also to be adjusted to account of any increase or decrease in the liability of the enterprise, as expressed in the reporting currency by applying the closing rate, for making payments towards the whole or a part of the cost of the assets or for repayment of the whole or a part of the monies borrowed by the enterprise from any person directly or indirectly, in foreign currency specifically for the purpose of acquiring those assets.

Thus the entire exchange loss due to variation of Rs. 50 lakhs on 31-3-2007 on payment of US $ 10 lakhs should be

added to the carrying amount of fixed assets and not to the cost of goods sold.

Further, depreciation on the unamortized depreciable amount should also be provided, in accordance with AS-6 on Depreciation Accounting.

Calculation Exchange loss:

Foreign currency loan = Rs. 1825 lakhs/ Rs. 36.50 lakhs = 50 lakhs US $

Exchange loss on outstanding loan on 31-3-2007 = 40 lakhs US $ X (41.50 – 36.50) = Rs. 200 lakhs should also be added to cost of fixed asset with corresponding credit to outstanding loan.

Calculation of additional depreciation on account of increase in the depreciable amount of fixed assets:

20% of Rs. 250 lakhs = Rs. 50 lakhs

Q3. A company had imported raw material worth US $ 250,000 on 15th January,2010 when the exchange rate was Rs. 46 per US $. The company had recorded the transaction at that rate. The payment for impost was made on 15th April, 2010 when the exchange rate was Rs. 49 per US $. However, on 31st March, 2010 the rate of exchange was Rs. 50 per US $. The company passed an entry on 31st March,2010 adjusting the cost of raw materials consumed for the difference between Rs. 49 and Rs. 46 per US $. State your view as an auditor.

Solution : Change in Exchange Rate: As per AS-11 on “The Effects of Changes in Foreign Exchange Rates” , Monetary items denominated in a foreign currency (e.g. foreign currency notes, balances in bank accounts denominated in a foreign currency, and receivables, payables and loans denominated in a foreign currency) should be reported using the closing rate. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date, e.g. where there are restrictions on remittances or where the closing rate is unrealistic and it not possible to effect an exchange of currencies at that rate at the balance sheet date. In such circum-stances, the relevant monetary item should be reported in the reporting currency at the amount, which is likely to be realised form, or required to disburse, such item at the balance sheet date. Sundry creditors are monetary items. The AS requires that on every balance sheet date, monetary items denominated in foreign currency should be reported using the closing rate. In the instant case, having regard on the fact that the amount payable for the raw material is a monetary item, the same would have to be shown in the balance sheet at the rate on the closing date of 31st March, 2010 i.e. Rs. 50, irrespective of the payment for the same subsequently at a lower rate.

Hence, the treatment given by the company is wrong and if the same is not rectified the auditors would have to qualify his report stating that AS-11 Requirements were not followed.

Q4. Someshwar Ltd. imported a machine on 04.01.2002 for Euros 12,000 on deferred payment basis; payment in six equal annual instalments at the end of every financial year, commencing from 31.03.2002 onwards. Use Revised AS-11 provisions irrespective of financial year/date and determine the exchange difference and carrying amounts of the liability at the end of each financial year, if the following exchange rates are given. One Euro equals Indian Rupees on

04.01.2002	31.03.2002	31.03.2003	31.03.2004	31.03.2005	31.03.2006	31.03.2007
50.4872	45.5208	41.8463	41.0175	42.6400	51.4400	53.1000

Solution : Calculation of Carrying Amounts of Liability:

Financial year ending	Euro amount due	Closing rate	carrying amount (Rs.)
31st March 2002	10,000	45.5208	4,55,208
31st March 2003	8,000	41.8463	3,34,770
31st March 2004	6,000	41.0175	2,46,105
31st March 2005	4,000	42.6400	1,70,560
31st March 2006	2,000	51.4400	1,02,880
31st March 2007	Nil	53.1000	Nil

Calculation of Exchange Differences:

Financial year ending	Exchange differences due to settlement	Exchange differences due to reporting
31st March 2002	2,000 X (50.4872 -45.5208) = 9,933 G	10,000 X (50.4872- 45.5208) = 49,664 G
31st March 2003	2,000 X (45.5208 –41.8463) = 7,349 G	8,000 X (45.5208 – 41.8463) = 29,396 G
31st March 2004	2,000 X (41.8463 – 410175) = 1,658 G	6,000 X (41.8463 - 41.0175) = 4,973 G
31st March 2005	2,000 X (41.0175 – 426400) = 3,245 L	4,000 X (41.0175 – 42.6400) = 6,490 L
31st March 2006	2,000 X(42.6400 –51,4400) =17,600 L	2,000 X (42.6400 – 51.4400) = 17,600 L
31st March 2007	2,000 X (51.4400 –53.1000) = 3,320 L	Nil

Note: G indicates Gain (credited to profit and loss account) while L indicates Loss (debited to profit and loss account) due to exchange differences.

Accounting Standard - 12

Q1. Induga Ltd. acquired the fixed assets of Rs. 500 lakhs on which it received the grant of 10%. What will be the cost of the fixed assets as per the AS-12 and its presentation in the Balance Sheet?

Solution : As per para 14 of AS-12 (refer point 12.3-2), Government grant related to specific fixed assets should be presented in the Balance sheet by showing the grant as a deduction from the grass value of the assets concerned in arriving at their book value. Therefore, 90% of Rs. 500 lakhs should be shown as addition to the fixed assets due to this transaction. Para 14 of AS-12 alternatively prescribed that the Government grant related to depreciable asset may be treated as deferred income which should be recognized in the profit and loss statement on a systematic and rational basis, over the useful life of the assets i.e., such grant should be allocated to income over the period and in the proportion in which depreciation on those assets be charged.

Q2. NDA Ltd. received a revenue grant of RS. 800 lakhs during the year 2007-08 from Government for welfare activities to be carried on by the company for its employees. The grant prescribed the condition for utilization, however during 2009-10 it was found that the condition of grant was not complied with and the grant had to be refunded to the Government. How this refund should be shown in the financial statement for the year 2009-10?

Solution : As per para 20 of AS-12 (refer point 12.5), Govt. grants that become refundable should be accounted for as an extraordinary item as per AS-5. Therefore, refund of grant should be shown in the Profit and Loss Statement of the company as an extraordinary item during the year 2009-10.

Q3. Induga Ltd. received a specific grant of Rs. 300 lakhs for acquiring the plant of Rs. 1,500 lakhs during 2006-07 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet during 2009-10 and due to non-compliance of conditions laid down for the grant of Rs. 300 lakhs the company had to refund the grant to the Government. Balance in the deferred income on that date was Rs. 270 lakhs and written down value of plant was Rs. 1,080 lakhs.

a. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2009-10 in profit and loss account?

b. What should be the treatment of the refund if grant was deducted from the cost of the plant during 2006-07?

Solution: As per para 21 of AS-12 (refer point 12.7), to the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

a. In this case the grant refunded is Rs. 300 lakhs and balance in deferred income is Rs. 270 lakhs, Rs. 30 lakhs shall be charged to the profit and loss account for the year 2009-10. There will be no effect on the cost of the fixed asset and depreciation charged will be same as charged in earlier year.

b. As per para 21 of AS-12 (refer point 12.7-2), the amount refundable in respect of grant which related to specific fixed assets should be recorded by increasing the book value of the assets by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively

over the residual useful life of the asset. Therefore, in this case the book value of the plant shall be increased by Rs. 300 lakhs. The increased cost of Rs. 300 lakhs of the plant should be amortised over 7 years (residual life). Depreciation charged during the year 2009-10 shall be 1200/10 + 300/7 = 162.86 lakhs. Presuming the depreciation on SLM.

Q4. Explain the treatment of the following:

i. A firm acquired a fixed asset for Rs. 250 lakhs on which the Government grant received was 40%

ii. Capital subsidy received from the Central Government for setting up a plant in the notified backward region. Cost of the plant Rs. 300 lakhs, subsidy received Rs. 100 lakhs.

iii. Rs. 50 lakhs received from the State Government for the setting up of water-treatment plant.

iv. Rs. 25 lakhs received from the local authority for providing medical facilities to the employees.

Solution :

i. The total cost of the fixed asset is Rs. 250 lakhs and the grant is 40% i.e., Rs. 100 lakhs. In the balance sheet, the asset will be shown at the net amount (Rs. 250 lakhs – Rs. 100 lakhs) i.e., Rs. 150 lakhs only. This will be depreciated over the life of the asset.

ii. In this case, the subsidy received for setting up a plant in the notified region, should be treated as a capital subsidy. The amount of subsidy i.e. Rs. 100 lakhs be added to the capital reserves and the plant should be shown at Rs. 300 lakhs.

iii. Rs. 50 lakhs received from state Government for setting up of water treatment plant should be deducted from the cost of the plant in the balance sheet.

iv. It is a case of revenue grant and should be shown in the profit and loss account. However, if the medical facilities are to be provided over a period of more than one year, it may be treated as deferred income and then taken to Profit and Loss Account on a systematic basis.

Q5. Top & Top Ltd. 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. Having fulfilled all the condition under the scheme, the company on its investment of Rs. 50 crore in capital assets, received Rs. 10 crore from the Government in January 2010 (accounting period being 2009-2010). 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, 2010. Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.

Solution : The action of the Top & Top Ltd. is not justified in view of Para 10 of AS-12. As per Para 10 of AS-12 "Accounting for Govt. Grants"

"Where the Govt. grant are of the nature of promoter contribution i.e. they are given with reference to the total investment in an undertaking or by way of promoters contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof the grants are treated as capital reserve, which can be neither distributed as

dividend nor considered as deferred income.”

Therefore it is inappropriate to recognize Government grants in the Profit & Loss statement for the year ended 31-3-2010. Since they are not earned but represent an incentive provided by Government without related cost.

Accounting Standard - 13

Q1. A company has invested a substantial amount in the shares of another company under the same management. The market price of the shares of the aforesaid company is about half of that at which these shares were acquired by the company. The management is not prepared to provide for the fall in the value of shares on the ground that the loss is only national till the time the shares are actually sold?

Solution : As per AS-13(refer point 13.7), for the purpose of determining carrying amount of shares the investment has to the classified into long-term and current; in the instant case it appears that the investment is long-term; hence it should be carried at cost, unless there is permanent diminution in value of investment. At the market price investment is half of its cost. The reduction appears to be heavy and permanent; hence the provision for permanent diminution (decrease) in value of investment should be made. The contention of management is not as per AS-13.

Q2. An unquoted long-term investment is carried in the books at cost of Rs. 2 lakhs. The published account of unlisted company received in May, 2002 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. How will you deal with it in the financial statement of investing company for the year ended 31-03-2002 presuming that accounts for the year were finalised in June 2002?

Solution : As per Para 32 of AS-13 (refer point 13.7), investments classified as long-term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investment, such reduction being determined and made for each investment individually. Para 17 of AS-13 states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On these bases, the facts of given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long-term investment of Rs. 20,000 in the financial statement for the year ended 31st March, 2002.

Q3. Canara Bank has classified its total investment on 31-3-2010 into three categories (a) held to maturity, (b) available for sale, (c) held for trading.

Held to maturity investment is carried at acquisition cost less amortised amount. Available for sale are carried at marked to market. Held for trading investments are valued at weekly intervals at market rates or as per the prices declared by FIMMDA. Net depreciation, if, any, is charged to revenue and net appreciation, if any, is ignored. Comment whether the policy of the bank is in accordance with AS-13?

Solution : As per Para 2(d) of AS-13 (refer point 13.3), the accounting standard is not applicable to bank, Insurance Company, Mutual funds; in this case CANARA Bank is a bank, therefore As-13 does not apply here. For the banks the RBI has issued guidelines for classification and valuation of the investment. Therefore, the CANARA Bank should comply with RBI guidelines.

Q4. Bharat Ltd. wants to re-classify its investments in accordance with AS-13. Decide on the amount of transfer, based on the following information :

1. A portion of Current Investments purchased for Rs. 20 lakhs, to be reclassified as Long term Investments, as the Company has decided to retain them. The market value as on the date of Balance Sheet was Rs. 25 lakhs.

2. Another portion of current investments purchased for Rs. 15 lakhs, to be reclassified as long term investments. The market value of these investments as on the date of balance sheet was Rs. 6.5 lakhs.

3. Certain long term investments no longer considered for holding purposes, to be re-classified as current investments. The original cost of these was Rs. 18 lakhs but had been written down to Rs. 12 lakhs to recognise permanent decline, as per AS-13.

Solution : The transfers should be made at lower of (a) Cost, and (b) Fair value at the date of transfer.

1. In this case, the transfer should be made at cost (being lower of Rs. 20) lakhs and Rs. 25 lakhs) and hence the long term investments should be carried at Rs. 20 lakhs.

2. In the second case, the transfer should be made at Market Value (being lower of Rs. 15 lakhs and Rs. 6.5 lakhs) and hence the long term investment should be carried at Rs. 6.50 lakhs. The loss of Rs. 15 – Rs. 6.5 = Rs. 8.5 lakhs should be provided for in the profit and loss account.

3. Here, the transfer should be made at carrying amount (being lower of Rs. 18 lakhs and Rs. 12 lakhs) and hence these reclassified current investments should be carried at Rs. 12 lakhs.

Q5. A Government company, on the directions of the Central Government, had made investment in the share of certain other companies. During the year, some of these investment were sold at profit of Rs. 4 crores and the same was treated as revenue profit for the year. The value of remaining investments on the balance sheet date had fallen by Rs. 3.60 crores for which no provision has been made in the accounts.

Ans: Provision should be made if there is permanent decline in value of investment

Accounting Standard - 15

Q1. The fair value of plan assets at the beginning and end of the year were Rs. 2,800 and Rs. 3,086 respectively. The employer's contributions to the plan during the year as Rs. 290. Benefit payments to retirees were Rs. 320. Calculate the actual return on plan assets.

Solution : The actual return is computed as follows:

	Amt. (Rs.)
Fair value of plan assets (beginning of year)	2,800
Plus : employer contribution	290
Plus : Actual Return	?
Less : Benefit Payments	(320)
Fair value of plan assets (ending of year)	3,086

The actual return equal to Rs. 316

Alternatively, the following formula may be used to derive the actual return :

Actual return = fair value of Asset (end of year) – fair value of assets (beginning of the year) – employer contribution + benefit payments

Actual return = Rs. 3,086 - Rs.2,800 – Rs. 290 + Rs. 320 = Rs. 316

Q2. The following data apply to a company's defined benefit pension plan for the year :

	Amt. (Rs.)
Fair market value of plan assets (beginning of year)	4,00,000
Fair market value of plan assets	5,70,000
Employer Contribution	1,40,000
Benefit paid	1,00,000

Calculate the actual return on plan assets.

Solution : The actual return is computed as follows:

	Amt. (Rs.)	Amt. (Rs.)
Fair market value of plan assets (end of year)		5,70,000
Fair market value of plan assets (beginning of year)		4,00,000
Change in plan assets		1,70,000
Adjusted for		
Employer contribution	1,40,000	
Less : Benefit paid	1,00,000	40,000
Actual return on plan assets		1,30,000

Q3. Based on the following information, calculate the actual return on pension plan assets :

	Amt. (Rs.)	Amt. (Rs.)
Benefit payments	1,00,000	
Contribution	1,30,000	
Fair market value of plan assets		
End of year		6,00,000
Beginning of year		4,00,000

Solution : The actual return on pension plan assets follows :

	Amt. (Rs.)	Amt. (Rs.)
Change in fair market value of plan assets		2,00,000
Adjustments :		
Employer Contribution	1,30,000	
Benefit payments	1,00,000	30,000
Actual return on plan assets		1,70,000

Q4. A company reports the following information regarding pension plan assets. Calculate the fair value of plan assets.

	Amt. (Rs.)
Fair market value of plan assets (beginning of year)	7,00,000
Employer contribution	1,00,000
Actual return on plan assets	50,000
Benefit payments to retirees	40,000

Solution : The actual return on pension plan assets follows :

	Amt. (Rs.)
Fair market value of plan assets (beginning of year)	7,00,000
Employer contribution	1,00,000
Actual return	50,000
Benefit payments	(40,000)
Fair market value of plan assets (end of year)	8,10,000

Q5. Induga Ltd. is an engineering industry. The company received an actuarial

Valuation for the first time for its pension scheme which revealed a surplus of Rs. 6 lakhs. It wants to spread the same over the next 2 year by reducing the annual contribution to Rs. 2 lakhs instead of Rs. 5 lakhs. The average remaining life of the employee is estimated to be 6 year. You are required to advice the company.

Solution : According to AS-15 (revised 2005) 'Employee Benefits' , actuarial gains and losses should be recognised immediately in the statement of profit and loss as income or expenses. Therefore, surplus amount of Rs. 6 lakhs is required to be credited to the profit and loss statement of the current year.

Accounting Standard - 16

Q1.	**Amt. (Rs.)**
Expenditure incurred till 31-03-2008	5,00,000
Interest cost capitalized for the financial year 2007-08 @ 13%	26,000
Amount borrowed till 31-03-08 is	2,00,000
Assets transferred to construction during 2008-09	1,00,000
Cash payment during 2008-09	75,000
Progress payment received	3,50,000
New borrowing during 2008-09 @ 13%	2,00,000

Calculate the amount of borrowing cost to be capitalised.

Solution : Total borrowing cost = 4,00,000 X 13/100 = Rs. 52,000

Expenditure incurred including previously capitalised borrowing cost (5,00,000 + 26,000)	5,26,000
Cash payment during 2009-10	75,000
Asset transferred during 2009-10	1,00,000
	7,01,000
Less : Progress payment received	3,50,000
	3,51,000

Money borrowed including previously capitalized interest cost 4,00,000 + 26,000 = 4,26,000

Borrowing cost to be capitalized = (3,51,000/ 4,26,000) X 52,000 = 42,845

Q2. Assume NDA Ltd. begins construction on a new building on 1st January, 2004. In addition, NDA Ltd obtained a Rs. 1 lakhs loan to finance the Construction of the building on 1st January, 2004 at an annual interest rate of 10%. The company's other outstanding debt during 2004 consist of two loans of Rs. 6 lakhs and Rs. 8 lakhs with interest rates of 11% and 13%, respectively. Expenditures that were made on the building project were as follows :

January 2004	200000
April 2004	300000
July 2004	400000
December 2004	120000

Solution :

Step 1

Computation of average accumulated expenses

Rs. 200,000 X 12/12 (January – December) = Rs. 200,000

Rs. 300,000 X 9/12 (April – December) = Rs. 225,000

Rs. 400,000 X 6/12 (July – December) = Rs. 200,000
Rs. 120,000 X 1/12 (December) = Rs. 10,000
Rs. 1020,000 Average accumulated Expenses = Rs. 635,000

Step 2

Compute the average interest rate based on the other outstanding debt of the entity other than specific borrowing :

600,000 X 11%	= Rs. 66,000
800,000 X 13%	= Rs. 104,000
1,400,000	Rs. 170,000

Average interest rate : Rs 170,000/1,400,000 = 12.14%

Step 3

Compute the interest on average accumulated expenses

Average Accumulated Expense (AAE)		interest to be capitalized (based on AAE)
100,000 (Specific borrowing) X 10%	=	10,000
535,000 (635,000 - 100,000) X 12.14%		64,950
635,000		74,950

Step 4

Compute actual interest costs incurred during the year

100,000	X	10%	=	Rs. 10,000
600,000	X	11%	=	Rs. 66,000
800,000	X	13%	=	Rs. 104,000
			Total	Rs. 180,000

Amount to be capitalized is Rs. 74,950 which is not more than actual interest of Rs. 180,000

(Amt. in Rs.)

Building Account	Dr.	1094950	
To Cash			1094950

Q3. On 30-04-2003 JLC Ltd. obtained a loan from the bank for Rs. 50 lakhs to be utilized as under :

Construction of shed	Rs. 20 lakhs
Purchase of Machinery	Rs. 15 lakhs
Working Capital	Rs. 10 lakhs
Advance for purchase of truck	Rs. 5 lakhs

In March 2004 construction of shed was completed and machinery installed. Delivery of truck was not received. Total

interest charged by the bank for the year ending 31-03-2004 was Rs. 9 lakhs. Show the treatment of interest under As-16.

Solution : As per AS-16 borrowing cost (interest) should be capitalised if borrowing cost is directly attributable to the acquisition, construction or production of qualifying asset. In other words, asset acquired must be qualifying asset and borrowing cost should be directly attributable to the acquisition, construction or production of qualifying asset.

In the question Rs. 50 lakhs borrowed from bank was utilized for-

Construction of a shed	Rs. 20 lakhs
Purchase of Machinery	Rs. 15 lakhs
Working Capital	Rs. 10 lakhs
Advance for purchase of truck	Rs. 5 lakhs

Out of these four payments only construction of a shed of Rs. 20 lakhs is a qualifying assets as per AS-16, other three payments are not for the qualifying asset. Therefore, borrowing cost attributable to the construction of a shed should only be capitalised which will be equal to Rs. 9 lakhs X 20/50 = Rs, 3.6 lakhs.

The balance of Rs. 5.4 lakhs (Rs. 9 lakhs – Rs. 3.6 lakhs) should be expensed and debited to profit and loss Account.

Q4. A company capitalizes interest cost of holding investments and adds to cost of investment every year, thereby understanding interest cost in profit and loss account. Whether unusual accounting.

Solution : The Accounting Standard Board (ASB) has opined that investments other than investment properties are not qualifying assets as per AS-16 Borrowing costs. Therefore, interest cost of holding such investments cannot be capitalized. Further, even interest in respect of investment properties can only be capitalized if such properties meet the definition of qualifying asset, namely, that it necessarily takes a substantial period of time to get ready for its intended use or sale, even where the investment properties meet the definition of 'qualifying assets', for the capitalisation of borrowing costs the other requirements of the standard such as that borrowing costs should be directly attributable to the acquisition or construction of the investment property and suspension of capitalisation as per paragraphs 17 and 18 of AS-16 have to be complied with.

Q5. Borrowing cost on the loans taken specifically to construct captive power plant is being capitalized even after the commencement of commercial production. The management argues that the borrowing cost is attributable solely and exclusively captive power plant and therefore should be capitalized. Give comment.

[Ans : Not Correct]

Accounting Standard - 17

Q1. Induga Ltd. has three divisions A,B and C. Details of their turnover, results and net assets are given below :

		Rs. ('000)
Division A		
	Sales to B	3,050
	Other sales (Home)	60
	Export Sales	4,090
		7,200
Division B		
	Sales to C	30
	Export sales to Europe	200
		230
Division C		
	Export Sales to America	180

	Head Office	Divisions A	B	C
Operating Profit or Loss before tax		160	20	(8)
Re-allocated Cost from head office		48	24	24
Interest costs		4	5	1
Fixed assets	50	200	40	120
Net current assets	48	120	40	90
Long term liabilities	38	20	10	120

Prepare a Segment Report for Publication in Induga Ltd.

Solution :

Induga Ltd.

Segment Report

	Divisions			Inter-segment Eliminations	Consoli-dated Total
	A	B	C		
Segment Revenue					
Sales :					
Domestic	60	-	-	-	60
Export	4,090	200	180	-	4,470
External sales	4,150	200	180	-	4,530
Inter-segment sales	3,050	30	-	3,080	-
Total revenue	7,200	230	180	3,080	4,530
Segment result (given)	160	60	(8)		172
Head office expense					(96)
Operating profit					76

Interest expenses				(10)
Profit before tax				66
Other information				
Fixed assets	200	40	120	360
Net current assets	120	40	90	250
Segment assets	320	80	210	610
Unallocated corporate Assets				98
Segment liabilities	20	10	120	150
Unallocated corporate Liabilities				38

Sales Revenue by Geographical Market

Home Sales	Export Sales(by Division A)	Export to Europe	Export to America	Consolidated Total
60	4,090	200	180	4,530

Q2. As per AS-17 "Enterprise revenue is revenue from sales to external customers as reported in the statement of profit or loss" and segment revenue is the aggregate of the portion of enterprise revenue that is directly attributable to a segment, the relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, and revenue from transactions with other segments of the enterprise. Segment revenue does no include:-

1. Extraordinary items as defined in AS-5, Net profit or Loss for the period, prior period items and changes in Accounting Policies;

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

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

   Comment whether other income like export incentives, lease rent interest from customers etc. should be included as segment revenue as per the above definition.

Solution : Other income should be included as part of the segment revenue if they do not fall under the exclusion definition and if it is essentially operating in nature. Other income will have to be analyzed into what is operating and non-operating, i.e. what belongs to be segment and what does not. Segment result is the net of the operating position and therefore includes income incidental to external turnover or the main activity of the segment. Export incentives are price subsidies for achieving exports in a fiercely competitive export market. Therefore they are indirectly a component of export turnover and should be included in segment revenue.

Non - operating interest should be excluded from segment revenue. However, interest received from customers due to delay in making payment is an operating income. Segment assets are those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Since receivables are part of the segment asset. The related income should be

included in segment revenue. This is because AS-17 requires that 'if the segment assets include the related income generating assets'. If however the enterprise is financing its customer then in addition to an operating segment it would also have a finance segment. For example, if an automobile company sells car on lease then besides automobile segment it would also have a leasing segment.

Rentals would be included in segment revenue if earned out of segment operating asset; i.e. those assets that are employed by a segment in its operating activities. Sometimes segment facilities are idle, and these may be used to earn rentals. Such income would be operating income and consequently form part of segment revenue. However, lease rent earned out of HO assets or assets that are not required for the operation of the segment, would not constitute segment revenue but would be included in the HO or 'unallocated column'.

Internal MIS though not conclusive would be helpful in the allocation of revenues, expenses, assets and liabilities to various segments.

Q3. Following is the regarding six segments of Z Ltd :

(Rs. In lakhs)

Particulars	**A**	**B**	**C**	**D**	**E**	**F**
Segment Revenue	150	310	40	30	40	30
Segment Result	25	(95)	5	5	(5)	15
Segment Assets	20	40	15	10	10	5

The Finance Director is of the view that it is sufficient that segment A and B alone be reported advise.

Solution : According to AS-17 on "Segment Reporting" issued by the ICAI, a business segment or geographical segment should be identified as a reportable segment if :

a. Its revenue from sales to external customers and from transaction with other segment is 10% or more of the total revenue, external and internal, of all segment; or

b. Its segment result, whether profit or loss, is 10% or more of :

i. The combined result of all segments in profit, or
ii. The combined result of all segments in loss,
Whichever is greater in absolute amount; or

c. Its segment assets are 10% or more of the total assets of all segments.

If total external revenue attributable to reportable segment constitute less than 75% of the total enterprise revenue, additional segment should be identified as reportable segments, even if they do not meet the 10% threshold until at least 75% of total enterprise revenue is included in reportable segments.

Based on the above criteria, following segments are reportable segment:

Basis	Reportable Segment
Segment Revenue	A & B
Segment Result	A,B & F
Segment Assets	A,B,C,D & E

Hence, the contention of the Finance Director that only segment A and B need reporting is not correct, as all the six segments are reportable segments.

Q4. Following details are given for NDA Ltd. for the year ended 31st March, 2010:

(Amt. in lakhs)

Sales :		
Food Products	5650	
Plastic and Packaging	625	
Health and Scientific	345	
Others	162	6782
Expenses :		
Food Products	3335	
Plastic and Packaging	425	
Health and Scientific	222	
Others	200	4182
Other Item:		
General corporate expense		562
Income from investments		132
Interest expenses		65
Identifiable Assets:		
Food products	7320	
Plastic and packaging	1320	
Health and Scientific	1050	
Others	665	10355
General corporate Assets		722

Other Information:

a. Inter-segment sales are as below:

	(Amt. in lakhs)
Food products	55
Plastic and Packaging	72
Health and Scientific	21
Others	7

b. Operating profit includes Rs. 33 lakhs on inter-segment sales.

c. Information about inter- segment expenses

You are required to prepare a statement showing financial information about NDA Ltd.'s operations in different industry segments.

Solution: Information about NDA Ltd.'s operations in different Industry segments is furnished in the following table :

	Food products	Plastic & packaging	Health & Scientific	others	Inter-segment elimination	Consol-idated
External Sales	5595	553	324	155	-	6627
Inter-segments	55	72	21	7	155	-
Total	5650	625	345	162	155	6627
Segment Expenses	3335	425	222	200	122	4060
Operating Profit	2315	200	123	(38)	33	2567
General Corporate Expenses						(562)
Income from Invest.						132
Interest					-	(65)
Income from continuing operations						2072
Identifiable assets	7320	1320	1050	665		10355
Corporate assets	-	-	-	-		722
Total assets						11077

Q5. Identify the reportable segment by profitability test is demonstrated as follows for XYZ Ltd.

Segment	Profit (Loss)
A	450
B	50
C	(350)
D	(40)
E	(210)

Solution: First, the operating segments are grouped according to whether they incurred a profit or loss, as follows:

Segments Incurring profit		Segments Incurring Losses	
Segment	**Profit (Rs.)**	**Segment**	**Loss (Rs.)**
A	450	C	(350)
B	50	D	(40)
	-	E	(210)
	500		600

From this point on in the profitability test, only absolute amounts are used. The combined total of those segments incurring a loss is larger than the combined total of those segment incurring a profit. Therefore, any segment for which the absolute amount of its operating profit or loss equals or exceeds Rs. 60 (i.e. 10% of Rs.600) meet the profitability test and is therefore a reportable segment. Segments A, C and E meet the profitability test, summarized as follows:

Operating Segment	Absolute amt. of Profit or loss	> Rs. 60	
A	450	Yes	(reportable segment)
B	50	No	
C	350	Yes	(reportable segment)
D	40	No	
E	210	Yes	(reportable segment)

If the total external revenue (i.e. sale to unaffiliated customers) of the reportable segment is less than 75% of total consolidated revenue, additional operating segments must be identified as reportable segments(even if they do not otherwise qualify as a reportable segment) until at least 75% of total consolidated revenue is included in reportable segments.

Information about all operating segments that did not qualify as reportable segments must be combined and disclosed in an "all other" category.

If an operating segment was identified in the immediately preceding prior period as a reportable segment and management deems that segment to be of continuing significance, information about that segment should continue to be reported separately in the current period even if that segment does not otherwise qualify as a reportable segment in the current period.

If an operating segment qualifies in the current period as a reportable segment but did not qualify as a reportable segment in the prior period (s), prior - period segment data presented for comparative purpose should be restated as if the segment qualified as a reportable segment in the prior period (s).

Q6. The Chief Accountant of Sport Ltd. gives the following data regarding its six segments:

Particulars	M	N	O	P	Q	R	Total
Segment Assets	40	80	30	20	20	10	200
Segment Result	50	-190	10	10	-10	30	-100
Segment Revenue	300	620	80	60	80	60	1200

The Chief Accountant is of the opinion that segments "M" and "N" alone should be reported. Is he justified in his view? Discuss.

Solution: No, he is not justified in his view, because as per Para 27 of As-17 "Segment Reporting", Business Segment or geographical segment which has been identified as reportable segment shall be further divided to include sub-segments based on the following conditions:

- Segment revenue from sales to external customers and internal transfer is 10% or more than total external and internal revenue of all segments.

  Or
- 10% or more of segment result
- (Segment result means if some segments are in loss then total loss of all loss making segments or if some segments are profit, total profit of all profit making segments. Whichever is higher i.e. total profit or total loss figure in absolute term.)

  Or
- Segment asset is 10% or more than total assets of all segments.
- Ensure whether at least 75% of total external revenue should be in the reportable segments.

In the question, the segments "M" and "N" are reportable segment on the basis of 10% of more segment revenue other two criteria should also be applied to make reportable segment as per AS-17. 10% of Segment result which is 20 or more (loss) (190+10) X 10%. By these criteria "R" is also reportable segment. As per the 10% or more asset criteria "O", "P" and "Q" also becomes the reportable segments; therefore all the 6 segments should be reportable segments.

Accounting Standard - 18

Q1. X ltd. sold to Y ltd. goods having a sales value of Rs. 25 lakhs during the financial year ended 31-3-2010. Mr. A, the Managing Director and Chief Executive of X ltd. owns nearly 100% of the capital of Y ltd. The sales were made to Y ltd. at the normal selling price of X ltd. The chief accountant of X ltd. does not consider that these sales should be treated any differently from and other sale made by the company despite being made to a controlled company, because the sales were made at normal and, that too, at arm's length prices. Discuss the above issue from the view point of AS-18.

Solution : Para 3 of AS-18 (refer point 18.2) describes related relationship as follows:

- Enterprises that directly or indirectly through one or more intermediaries control or are controlled by or are under the common control with the reporting enterprises (including holding companies).
- Associates and joint ventures of reporting enterprise.
- Individuals holding directly or indirectly an interest in the voting powers of reporting enterprise giving control or significant influence over the enterprise.
- Key management personnel and relative of such personnel.
- Enterprise over which any person described above is able to exercise significant influence.

Accordingly, the sale of goods worth Rs. 25,00,000 falls under the purview of para 3 of AS-18 (refer point 18.2) and hence the following information should be provided as per para 23 of AS-18 (refer point 18.7)

- The name of the transaction related party
- Description of relationship between the parties
- Nature of transaction
- Volume of the transaction either as an amount or as an appropriate proportion
- The amount or, appropriate proportion of outstanding items pertaining to related parties at the balance sheet date and provision for doubtful dues from such parties at the date
- Amount written off or written back in the period in respect of debts due from or related parties.

Q2. If a majority of directors of one company constitutes the majority of the board of another company in their individual capacity as professional (and not by virtue of their being directors in the first company), can it be considered that the companies are related?

Solution : The companies are not related merely because the majority of the directors of one became the majority of directors of the second in their individual capacity as professional.

As per the definition of 'control' as contained in paragraph 10 of the Statement, the ability to control is gained by : "Ownership, directly or indirectly, of more than one-half of the voting power of an enterprise, or

Control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or A substantial interest in voting power and the power to direct, by statute or agreement, the financial and /or operating policies of the enterprise ".

Further, as per paragraph 11 of the statement, an enterprise is considered to control the composition of the board of directors of a company, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors of that company. In the given example, the first company cannot be said to control the composition of the board of directors of the second company as the directors have been appointed in their individual capacity and not by virtue of their being directors in the first company.

Further, an evaluation is required to ascertain whether any of the directors has a relationship with both companies [as specified in paragraph 3(c) and (d) which would create a related party relationship between the two companies]. Such relationship would include these directors being key management personnel in both companies, being a key management person in one company and owning an interest in another, which enables him to exercise significant influence etc.

Q3. Is remuneration paid to key management personnel or Non-Executive Directors or Board of Directors, a related party transaction?

Solution : Key Management Personnel are related parties under AS-18. Hence, remuneration paid to key Management Personnel will be related party transaction requiring disclosure under AS-18.

Non-Executive Directors or the board of directors are not related parties as per Accounting Standard Interpretation (ASI) 21.So, remuneration paid to them will not be considered a related party transaction.

Q4. NDA Co. acquired 100% of Induga Corp. prior to 2009. During 2009, the individual companies included in their financial statement the following:

	NDA	Induga
Officers' salary	75,000	50,000
Officers' expenses	20,000	10,000
Loans to officers	125,000	50,000
Inter-company sales	150,000	-

What amount should be reported as related party disclosures in the notes the NDA 2001 consolidated financial statements?

a. 150,000 b. 155,000 c. 175,000 d. 330,000

Ans: (a)

Q5. During 2009-10, AD Softex India Ltd. engaged in the following transactions:

Salary expenses to key employees who are also principle owners 100,000

Sales to affiliated enterprises 250,000

Which of the two transactions would be disclosed as related-party transactions in AD Softex India Ltd. 2009-10 financial statements?

a. Neither transaction only.
b. Rs. 100,000 transactions only.
c. Rs.250,000 transactions only
d. Both transactions.

Ans : (d)

Accounting Standard - 19

Q1. AD Softex Ltd. has taken the assets on lease form ACS Impex Ltd. The following information is given below:

Lease term	=	4 years
Fair value at inception of lease	=	Rs. 16,00,000
Lease Rent	=	Rs. 5,00,000 p.a. at the end of year
Guaranteed Residual Value	=	Rs. 1,00,000
Expected Residual Value	=	Rs. 3,00,000
Implicit Interest Rate	=	14.97%

How the accounting is done in the book of lessor?

Solution : Lessor should recognize asset given under lease at net investment in lease.

Net investment in lease = Gross investment - unearned finance income

Gross investment = MLP + Guaranteed residual value + unguaranteed residual value
= 2000000+100000+200000
= 2300000

Unearned finance Income = Gross investment – present value of gross investment

Present year	Value of MLP	Gross Investment Discount factor	Present value
1	500000	0.8698	434900
2	500000	0.7565	378250
3	500000	0.6580	329000
4	800000	0.5724	457920
	2300000		1600070 say 1600000

Unearned finance income = 2300000 – 1600000 = Rs. 700000

Apportionment of MLP into Capital recovery & finance income

Year	Balance of lease Receivable	Cash receipts	Finance	Capital recovery reduced from Receivable
0	16,00,000	-	-	-
1	13,39520	5,00,000	2,39,520	2,60,480
2	0,40,045	5,00,000	2,00,525	2,99,475
3	6,95,740	5,00,000	1,55,695	3,44,304
4		8,00,000	1,04,260	6,95,747
			7,00,000	16,00,000

The lease receivable account shown in the books of lessor will not tally with the lease liability account as shown by the lessee in his book. Difference will remain because of guaranteed residual value from the third party or/and unguaranteed residual value from the lessee point of view.

Q2. R ltd. (the lessee) acquired machinery on lease from S ltd. (the Lessor) on January 1, 2000. The lease term covers the entire economic life of the machinery i.e. 3 years. The fair value of the machinery on January 1, 2000 is Rs. 3,50,000. The lease agreement requires the lessee to pay on amount of Rs. 1,50,000 per year beginning December 31,200. The lessee has guaranteed a residual value of Rs. 11,400 pm December 31, 2002 to the lessor. The lessor however estimates that machinery will have a salvage value of only Rs. 10,000 on December 31, 2002. The implicit rate of interest is 15% p.a. Compute the value of machinery to be recognized by the lessee and also the finance charges every year on the basis of AS19. PV Factor of 15% in three years is 2.283.

Solution: As per para 11 of AS-19 (refer point 19.5). At the inception of a finance lease, the lessee should recognize the lease as an asset and a liability. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of leased asset exceeds the present value of minimum lease payments from the standpoint of the lessee, the amount recorded, as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee. In this case fair value of the machinery is Rs. 3,50,000 and the net present value of minimum lease payment from the standpoint of lessee is also Rs. 3,50,000 (appox.). As the net present value of minimum lease payment is not less than the fair value, then the machinery will be recognized by the lessee at Rs. 3,50,000.

Present value of minimum lease payment:

Annual lease rental X P.V. Factor + Present value of Guaranteed residual value

= 1,50,000 X (0.8695 + 0.7561 +.-0.6575) + 11,400 X 0.6575

= 3,42,465 +7,496 = Payment Rs. 3,49,961. Rounded off to 3,50,000

Year	Finance Charges	Payment	Reduction in Outstanding Liability	Outstanding Liability
1 (1st Jan)	-	-	-	3,50,000
(31st Dec)	52,500	1,50,000	97,500	2,52,500
2 (31st Dec)	37,875	1,50,000	1,12,125	1,40,375
3(31st Dec)	21,056	1,50,000	1,28,944	11,431

Q3. NDA ltd. availed a lease from Induga ltd. on following terms:

- A lease for a tenor of 3 years, in the beginning of year 2001 for equipment costing Rs. 7,00,000 and which has an expected useful life of 5 years. The fair market value is also Rs. 7,00,000.
- 3 equal annual payments are made at end of each year.
- The property reverts back to the lessor on termination of the lease.
- The unguaranteed residual value is estimated at Rs. 75,000 at the end of year 2003.
- IRR = 10%
- The present value of Re. 1 due at the end at the end of 3rd year at 10% IRR is Rs.0.7513
- The present value of annuity of Re. 1 due at the end at the end of 3rd year at 10% IRR is Rs.2.4868

a. State with reason whether the lease constitute finance lease

b. Calculate unearned finance income

Solution:

i. Computation of Annual payment to the lessor
PV of residual value (Rs.) = 75,000 X 0.7513 = 56,348

PV of lease payments (Rs.) = 7,00,000 - 56,348 = 6,43,652

Annual payments (Rs.) = 6,43,652 / 2.4868 = 2,58,817

The present value of lease payments i.e. Rs. 6,43,652 equals 92% of the fair market value i.e. Rs. 7,00,000. As the present value of minimum lease payment substantially covers the initial fair value of the leased assets and leased term (3 years) covers the major part of the life of assets (5 years). Therefore, it constitutes a finance lease.

ii. Computation of unearned finance income	Amt. (Rs.)
Gross investment in the lease	8,51,451
(3 X 2,52,817) + 75,000	
Cost of leased property	7,00,000
Unearned finance income	1,51,451

Q4. On January 1, 2006, Milestones Ltd. sold equipment to Induga Ltd. for Rs. 12,28,920. The carrying amount of the equipment on that date was Rs. 2,00,000. The sale was a part of the package under which Induga ltd. leased the asset to Milestones ltd. for a ten-year term. The economic life of the asset is estimated at 10 years. The minimum lease rents payable by the lessor has been fixed at Rs. 2,00,000 payable annually beginning December 31, 2006. The incremental borrowing interest rate of Milestones ltd. is estimated at 10% per annum. Calculate the net effect on the

profit and loss account?

Solution : The PV of minimum lease payment at 10% discount rate
= 200,000 X 6.1446 = Rs. 12,28,920

Milestones Ltd. should recognize the asset and the liability at Rs. 12,28,920.

The excess of sale over carrying amount
= (Rs. 12,28,920 – 2,00,000) = Rs. 12,28,920

Assume that Milestones ltd. has decided to charge depreciation on straight line basis. AS-19 requires Milestones Ltd to :

a. Recognize depreciation at Rs. 1,22,892 per annum for 10 years

b. Allocated excess of Rs. 10,28,920 over the lease term at the rate of Rs.1,02,892 per annum.

The net effect is a debit of (Rs.1,22,892 – 1,02,892) or Rs. 20,000 per annum to the profit and loss account for 10 year, as covered under the lease term.

Had there been no sale and lease back transaction, the profit and loss account for each year covered in the lease term would have been charged by (Rs. 2,00,000 / 10) or Rs. 20,000, towards depreciation. Thus, the sale and lease back transaction has no impact on profit or loss to be reported by the lessee (vendor in the sale transaction) over the lease period.

The deferred income (excess) should be presented as a deduction from the carrying amount of the asset. Thus, the asset should be presented by Milestones ltd. in its balance sheet dated December 31, 2006 as follows:

	Rs.
Gross Block	12,28,920
Less : Accumulated depreciation	1,22,892
Net Block	11,06,028
Less : Deferred Income	9,26,028
Net block	1,80,000

In effect, the carrying amount of the equipment does not change with the sale and lease back transaction. In substance, the sale and lease back transaction is a borrowing transaction resulting in recognition of a liability in the balance sheet and recognition of interest expense in the profit and loss account.

Q5. A ltd. leased a machinery to B ltd. on the following terms :

	(Rs. In Lakhs)
Fair value of the machinery	20.00
Lease term	5 years
Lease rental per annum	5.00

Guaranteed Residual value	1.00
Expected residual value	2.00
Internal Rate of Return	15%

Depreciation is provided on Straight line method @ 10% per annum. Ascertain unearned financial income and necessary entries may be passed in the books of the Lessee in the First year.

Solution :

Present value of MLP (for Lessee)

Year	MLP	Discount Rate	PV
1	500000	0.8696	434800
2	500000	0.7561	378050
3	500000	0.6575	328750
4	500000	0.5718	285900
5	600000	0.4972	298320
			1725820

Note :

It has been assumed that the lease rent is paid at the end of the year

Present value of MLP is less than fair value of Rs. 2000000, so the leased asset and liability should be recognized at Rs. 1725820 in the books of lessee (B ltd.)

Calculation of unearned finance income

Unearned finance income = Gross investment - PV of Gross Investment.

For the Lesser.

Year	MLP	Discount Rate	PV
1	500000	0.8696	434800
2	500000	0.7561	378050
3	500000	0.6575	328750
4	500000	0.5718	285900
5	700000	0.4972	348040
	2700000		1775540

Unearned finance Income : 2700000 - 1775540 = Rs. 924460

Apportionment of MLP into finance charge and principal amount at the end of the year.

Year	Liability	MLP	Finance Charges	Principal
0	1725820	-	-	-
1	1484693	500000	258873	241127
2	1207397	500000	222704	277296
3	1207397	500000	181110	318890
4	888507	500000	133276	366724
5	-	600000	78267	521733

Entries in the books of B ltd. (lessee) in first year

Machinery (leased) A/c	Dr.	1725820	
To lease liability			1725820
Depreciation A/c	Dr.	172582	
To Machinery A/c			172582
Lease Liability A/c (A Ltd.)	Dr.	241127	
Finance charge	Dr.	258873	
To Bank			500000
Profit & Loss A/c	Dr.	431455	
To Depreciation A/c			172582
To Finance Charges			258873

Q6. An equipment is leased for 3 years and its useful life is 5 years. Both the cost and the fair market value of the equipment are Rs. 3,00,000. The amount will be paid in 3 instalments and at the termination of lease lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is Rs. 40,000. The (internal rate of return) IRR of the investments is 10%. The present value of annuity factor of Re. 1 due at the end of 3rd year at 10% rate of interest is 0.7513.

i. State with reason whether the lease constitute finance lease
ii. Calculate unearned finance income.

Solution : As per the question, IRR of the investment is 10%

Investment in lease is Rs. 3,00,000

If IRR is 10% that means P.V. of minimum lease payment (MLP) from lessor point of view plus unguaranteed residual value is equal to Rs. 3,00,000.

P.V. of unguaranteed residual value

(40,000 X 0.7513 = Rs. 30,052

P.V. of M.L.P. should be (3,00,000 – 30,052) = Rs. 2,69,948

As at the beginning of lease period the P.V. Of MLP cover substantially the initial fair value i.e. 2,69,948 / 3,00,000 = 90% approx

Moreover lease period covers major part of the lease of the asset

Hence, it is a finance lease.

Calculation of annual lease payment to the lessor -

2,69,948 / 2.4868 = Rs. 1,08,552

Gross investment in lease - 1,08,552 X 3 =	Rs. 3,25,657
Unguaranteed residual value -	Rs. 40,000
	3,65,657
Less : PV of Gross investment in lease	3,00,000
Unearned finance income	65,657

Accounting Standards - 24

Q1. From the following information prepare the required profit/loss statement for continuing and discontinuing operation as required by AS-24:

- X Company has three segments, Food Division, Tea Division and Garments Division.
- Garments Division, is deemed inconsistent with the long-term strategy of the Company. Management has decided, therefore, to dispose of the Garments Divisions.
- On 15th November, 2001, the Board of Directors of X Company approved a detailed, formal plan for disposal of Garments Division, and an announcement was made. On that date, the carrying amount of the garments division's net assets was Rs. 90 crores (assets of Rs. 105 crores minus liabilities of Rs. 15 crores).
- The recoverable amount of the assets carried at Rs. 105 crores was estimated to be Rs. 85 crores and the Company had concluded that a pre-tax impairment loss of Rs. 20 crores should be recognized.
- At 31 December, 2001, the carrying amount of garment division's net assets was Rs. 70 crores (assets of Rs. 85 crores minus liabilities of Rs. 15 crores). There was no further impairment of assets between 15 November, 2001 and 31 December, 2001 when the financial statements were prepared.
- On 30 September, 2002, the carrying amount of the net assets of the garments division continued to be Rs. 70 crores. On that day, X Company signed a legally binding contract to sell the Garments Division.
- The sale is expected to be completed by 31 January, 2003. The recoverable amount of the next assets is Rs. 60 crores. Based on that amount, an additional impairment loss of Rs. 10 crores is recognized.
- In addition, prior to 31 January, 2003, the sale contract obliges X company to terminate employment of certain employees of the Garment Division, which would result in termination cost of Rs. 30 crores, to be paid by 30 June, 2003. A liability and related expense in this regard is also recognized.
- The Company continued to operate the garments division throughout 2002.
- At 31 December, 2002, the carrying amount of the garments division's net assets is Rs. 45 crores, consisting of assets of Rs. 80 crores minus liabilities of Rs. 35 crores (including provision for expected termination cost of Rs. 30 crores).
- X Company prepares its financial statements annually as of 31 December. It does not prepare a cash flow statement.

Other figures are assumed for the required disclosure as per AS-24 in the solution.

Solution

I. Financial Statements for 2001

1.1 Statement of Profit and Loss for 2001 (See Point 24.5)

The statement of Profit and Loss of X Company for the year 2001 can be presented as follows:

(Amount in Rs. crores)

	2001	**2000**
Turnover	140	150
Operating expenses	(92)	(105)
Impairment loss	(20)	(-)
Pre-tax profit from operating activities	28	45
Interest expense	(15)	(20)
Profit before tax	13	25
Profit from continuing operations before tax (see Note)	15	12
Income-tax expense	(7)	(6)
Profit from continuing operations after tax	8	6
Profit (loss) from discontinuing operations After tax (see Note)	(2)	(13)
Income-tax expenses	1	7
Profit (loss) from discontinuing operations after tax	(1)	6
Profit from operating activities after tax	(7)	(12)

1.2 Note to Financial Statements for 2001 (see point 24.5)

The following is Note to X Company's financial statements:

On 15 November, 2001, the Board of Directors announced a plan to dispose of Company's Garments Division, which is also a separate segment as per AS 17, Segment Reporting. The disposal is consistent with the Company's long-term strategy to focus its activities in the areas of tea manufacture and distribution, and to divest unrelated activities. The Company is actively seeking a buyer for the garment division and hopes to complete the sale by the end of 2002. At 31 December, 2001, the carrying amount of the assets of the garments division was Rs. 85 crores (previous year Rs. 120 crores) and its liabilities were Rs. 15 crores (previous year Rs. 20 crores). The following statement shows the revenue and expenses of continuing and discontinuing operations:

(Amount in Rs. crores)

	Continuing Operations (Food and Tea Divisions)		Discontinuing Operation (Garments Division)		Total	
	2001	2000	2001	2000	2001	2000
Turnover	90	80	50	70	140	150
Operating Expenses	(65)	(60)	(27)	(45)	(92)	(105)
Impairment Loss -	-	20)	(-)	(20)	(-)	
Pre-tax profit from Operating Activities	25	20	3	25	28	45
Interest expenses	(10)	(8)	(5)	(12)	(15)	(20)
Profit (loss) before tax	15	12	(2)	13	13	25
Income-tax expense	(7)	(6)	1	(7)	(6)	(13)
Profit (loss) from Operating Activities after tax	8	6	(1)	6	7	12

II. Financial Statements for 2002

2.1 Statement of Profit and Loss for 2002

The Statement of Profit and Loss of X Company for the year 2002 can be presented as follows:

(Amount in Rs. Crores)

	2002	**2001**
Turnover	140	140
Operating expenses	(90)	(92)
Impairment loss	(10)	(20)
Provision for employee termination benefits	(30)	-
Pre-tax profit from operating activities	10	28
Interest expense	(25)	(20)
Profit before tax	(15)	13
Profit from continuing operations before tax (see Note)	20	15
Income-tax expense	(6)	(7)

Profit from continuing operations after tax	14	8
Profit (loss) from discontinuing operations after tax (see Note)	(35)	(2)
Income-tax expenses	10	1
Loss from discontinuing operations after tax	25	1
Profit (loss) from operating activities after tax	(11)	7

2.2 Note to Financial Statements for 2002

The following is Note to X Company's financial statements:

On 15 November, 2001, the Board of Directors had announced a plan to dispose of Company's garments division, which is also a separate segment as per AS-17, Segment Reporting. The disposal is consistent with the Company's long-term strategy to focus its activities in the areas of food and tea manufacture and distribution, and to divest unrelated activities. On 30 September, 2002, the Company signed a contract to sell the Garments Division to Z Corporation for Rs. 60 crores.

Garments Division's asset written down by Rs. 10 crores (previous year Rs. 20 crores) before income-tax saving of Rs. 3 crores (previous year Rs. 6 crores) to their recoverable amount.

The company has recognized provision for termination benefits of Rs. 30 crores (previous year Rs. nil) before income-tax saving of Rs.9 crores (previous year Rs. nil) to be paid by 30 June, 2003 to certain employees of the garments division whose jobs will be terminated as a result of the sale.

At 31 December, 2002, the carrying amount of assets of the garments division was Rs.80 crores (previous year Rs. 85 crores) and its liabilities were Rs 35 crores (previous year Rs. 15 crores), including the provision for expected termination cost of Rs. 30 crores (previous yea Rs. nil). The process of selling the garments division is likely to be completed by 31 January, 2003.

The following statement shows the revenue and expenses of continuing and discontinuing operations:

(Amount in Rs. crores)

	Continuing Operations (Food and Tea Divisions)		Discontinuing Operation (Garments Division)		Total	
	2001	2002	2001	2002	2001	2002
Turnover	90	100	50	40	140	140
Operating Expenses	(65)	(60)	(27)	(30)	(92)	(90)
Impairment Loss -	-	(20)	(10)	(20)	(10)	

	Continuing Operations (Food and Tea Divisions)		Discontinuing Operation (Garments Division)		Total	
	2001	2002	2001	2002	2001	2002
Provision for employee Termination	-	-	-	(30)	-	(30)
Pre-tax profit from Operating Activities	25	40	3	(30)	28	10
Interest expenses	(10)	(20)	(5)	(5)	(15)	(25)
Profit (loss) before tax	15	20	(2)	(35)	13	(15)
Income-tax expense	(7)	(6)	1	10	(6)	4
Profit (loss) from operating activities after tax	8	14	(1)	(25)	7	11

Q2. A healthcare goods producer has changed the product line as follows:

	Washing soap	Bathing soap
January 2004 - September 2004 per month	2,00,000	2,00,000
October 2004 - December 2004 per month	1,00,000	3,00,000
January 2005 - March 2005 per month	0	4,00,000

The company has enforced a gradual enforcement of change in product line on the basis of an overall plan. The Board of Directors of the Company has passed a resolution in March, 2004 to this effect. The company follows calendar year as its accounting year. Should it be treated as discontinuing operation?

Solution: Business enterprises frequently close facilities, abandon products, or even product lines, and reduce the size of their workforce in response to market forces. These kinds of terminations generally, are not in themselves discontinuing operations unless they satisfy the definition criteria. By gradually reducing the size of operations in the product line of Washing Soap, the company has increased its scale of operations in Bathing Soap. Such a change is a gradual or evolutionary, phasing out of a product line or class of services does not meet definition criteria in paragraph 3(a) of AS 24 - namely, disposing of substantially in its entirety, a component of the enterprise. Hence, this changeover is not a discontinuing operation.

Accounting Standard - 25

Q1. On 1st April 2009, Builders Associates entered into a Rs. 5,00,000 fixed price contract to construct a factory building for manufacturing company. Builder Account for this contract under the percentage of completion and estimated costs at completion at the end of each quarter for financial year 2009-2010.

	Qtr. I	Qtr. II	Qtr. III
Cumulative costs incurred to date	150000	360000	405000
Estimated cost yet to be incurred at Quarter end	300000	40000	-
Progressing billing made during quarter	100000	370000	30000
Collections of billing	75000	300000	125000

What amount builder as income should report on "Construction Contract" in its quarterly income statement based on the above information.

Solution :

Income statement
(Percentage of completion method)

	Qtr. I	Qtr. II	Qtr. III	Total
Contract revenue earned	166667*	283333**	50000***	500000
Cost of revenue earned	(150000)	(210000)	(45000)	(405000)
Gross Profit	16667	73333	5000	95000

Working notes : *150000/450000 X 500000 = Rs.166667
**360000/400000 X 500000 - 166667 = Rs. 283333
*** 405000/405000 X 500000 - 166667 - 283333 = Rs. 50000

Notes

1. The revenue and the cost has been calculated as per discrete view of revenue and expenses recognition (refer point 25.5-2)

2. Change in estimate of total cost incurred in each quarter has not been given retrospective effect as per the discrete view of income and expense recognition because there is no change in accounting policy.

Q2. Induga Corporation is dealing in seasonal product sales pattern of the product, quarter wise is as under :

1st Qtr. ending 30 June	IInd Qtr. ending 30 Sep.	IIIrd Qtr. ending 31st Dec.	IVth Qtr. ending 31 Mar.
15%	15%	50%	25%

For the first quarter ending on 30 June, 2002 Induga ltd. gives you the following information :

Sales	50 crores
Salary and other Exps.	30 crores
Advertisement Exps. (Routine)	2 crores
Administrative and selling Exps.	8 crores

Induga Ltd. while preparing interim financial report for first quarter wants to defer Rs. 16 crores expenditure to third quarter on the argument that third quarter is having more sales therefore third quarter should be debited by more expenditure. Considering the seasonal nature of business and that the expenditures are uniform throughout all quarters.

Calculate the result of first quarter as per AS-25 and comment on the company view.

Solution : Result of the first quarter ending 30th June

	(Rs. In crores)	
1. Turnover		50
2. Other Income		Nil
Total		50
Less: Changes in inventories	Nil	
Salaries and other cost	30	
Administrative and selling Exps. (8+2)	10	
Total		40
Profit		10

Note - As per the AS-25 the income and expense should be recognized when they are earned and incurred respectively. Seasonal incomes will be recognized when they occur. Therefore the argument of the Induga Corporation is not as per AS-25.

Q3. NDA ltd. present interim financial report (IFR) quarterly, earn Rs. 600 lakhs pre-tax profit in the first quarter ending 30-06-2010 but expect to incur losses of Rs. 200 lakhs in each of the three remaining quarters. Which will result Zero income during the financial year effective income tax rate is expected to be 35%. Calculate the income tax expense to be reported in each quarter as per AS-25.

Solution :

I Qtr	Tax expenses to be reported	600 X 35% = Rs. 210 lakhs
II Qtr	Tax expenses to be reported	200 X 35% = Rs. (-) 70 lakhs
III Qtr	Tax expenses to be reported	200 X 35% = Rs. (-) 70 lakhs
IV Qtr	Tax expenses to be reported	200 X 35% = Rs. (-) 70 lakhs
	Annual Tax expense	Nil

Q4. Induga Ltd. accounting year ends on 30th September, 2010 and report quarterly. However for the purpose of tax year-end on 31st March every year. For the accounting year beginning on 1-10-2009 and ends on 30-9-2010, the quarter income is as under:

Qtr ending 31-12-2009	Rs. 400 lakhs
Qtr ending 31-3-2010	Rs. 400 lakhs
Qtr ending 30-6-2010	Rs. 400 lakhs
Qtr ending 30-9-2010	Rs. 400 lakhs
Total	Rs. 1,600 lakhs

Average actual tax rate for the financial year ending on 31-3-2010 is 30% and for the financial year ending 31-3-2011 is 40%. Calculate tax expense for each quarter.

Solution :

Tax expense	for quarter ending on
31-12-2009	Rs. 120 lakhs (400 X 30%)
31-3-2010	Rs. 120 lakhs (400 X 30%)
30-6-2010	Rs. 160 lakhs (400 X 40%)
30-9-2010	Rs. 160 lakhs (400 X 40%)

Q5. NDA Ltd. presents interim financial report quarterly. On 1-4-2009, NDA Ltd. has carried forward loss of Rs. 400 lakhs for income-tax purpose for which deferred tax assets has not been recognized. The NDA ltd. earns Rs. 500 lakhs each for quarter ending on 30-6-2009, 30-9-2009, 31-12-2009 and 31-3-2010 excluding the loss carried forward. Income tax rate is expected to be 40%. Calculate the amount of tax expense to be reported in each quarter.

Solution :

The estimated payment of the annual tax on Rs. 2,000 lakhs earning for current year.

(2,000 lakhs – Rs. 400 lakhs) = Rs. 1,600 lakhs

Rs. 1,600 X 40/100 = Rs. 640 lakhs

Average annual to be shown each quarter will be 500 X 32/100 = Rs. 160 lakhs

Q6 THDC ltd. shows the net profit of Rs. 5,40,000 for Quarter III incorporating the following:

i. Bad debt of Rs. 30,000 incurred during the year. 50% of the bad debt has been deferred to next quarter.
ii. Extraordinary loss of Rs. 28,000 incurred during the quarter has been fully recognized in this quarter.
iii. Additional depreciation of Rs. 36,000 resulting from the change of method of depreciation.

Do you agree with the treatment adopted by the company? If not, find out correct quarterly income as per AS-25?

Solution: In the above case, the quarterly income has not been correctly stated. As per AS-25 the quarterly income should be adjusted and restated as follows:

Bad debt of Rs. 30,000 has been incurred during the current quarter. Out of this the company has deferred 50% i.e. Rs. 15,000 to next quarter. This is not correct. Rs.15,000 therefore, should be deducted from Rs. 5,40,000

The treatment of extraordinary loss of Rs. 28,000 being recognized in the same quarter and recognizing the additional depreciation of Rs. 36,000 in the same quarter is correct and in tune with AS-25. So, no adjustment required for these two items.

The company should report the quarterly income as Rs.5,25,000 (i.e. Rs. 5,40,000 - Rs. 15,000).

Accounting Standard - 26

Q1. On January 2, 2010 NDA Corp. bought a trademark from Induga Corp. fro Rs. 500,000. NDA retained an independent consultant, who estimated the trademark's remaining life to be 20 years. Its unamortized cost on Induga accounting records was Rs. 380,000. NDA decided to amortize the trademark over the maximum period allowed. In NDA's December 31, 2010 balance sheet, what amount should be reported as accumulated amortization?

a. Rs. 7,600 b. Rs. 9,500 c. Rs. 25,000 d. Rs. 50,000.

Solution : (d)
As per para 23 of AS-26 (refer point 26.8), intangible assets should be measured initially at cost therefore, NDA Company should amortize the trademark at its cost of Rs. 500,000. The unamortized cost on the seller's books (Rs. 3,80,000) is irrelevant to the buyer. Although the trademark has a remaining useful life of 20 years, intangible assets is generally amortized over a maximum period of 10 years per AS-26 (refer point 26.16-2). Therefore, the 2010 amortization expense and accumulated amortization is 50,000 (Rs. 5,00,000 / 10 years).

Q2. On January 2, 2010, NDA Co. purchased Induga Co. at a cost that resulted in recognition of goodwill of Rs. 2,00,000 having an expected benefit period of 10 years. During the first quarter of 2010, NDA spent an additional sum of Rs. 80,000 on expenditures designed to maintain goodwill. At December 31, 2010, NDA estimated that the benefit period of goodwill was 20 years. In its December 31, 2010 balance sheet, what amount should NDA report as goodwill? (AS-14 not applicable)

a. .Rs. 1,80,000, b. Rs. 1,90,000, c. Rs. 2,52,000, d. Rs. 2,73,000.

Solution : (b)
As per paras 23 and 27 of AS-26 (refer point 26.8), the company should record as an asset the cost of intangible assets such as goodwill acquired from other entities. Para 60 of AS-26 (refer point 26.15) also states that subsequent expenditure on a recognized intangible asset is recognized as an expense if this expenditure is required to maintain the asset at its originally assessed standard of performance. In addition, it is difficult to attribute Rs. 80,000 expenditure directly to goodwill rather than the business as a whole. Cost of developing intangible assets such as goodwill "which are not specifically identifiable, have indeterminate lives, or are inherent in continuing business and related to an enterprise as a whole" should be expensed when incurred. Therefore, only Rs. 2,00,000(and no the additional Rs.80,000) should be capitalized as goodwill. Amortization at 31-12-2010 is recorded using the best estimate of useful life at that time (20 years). Therefore, the net amount reported for goodwill at 31-12-2010 is Rs. 1,90,000[Rs. 2,00,000 – Rs.2,00,000 X 1/20]. Goodwill has been amortized presuming that NDA corp. has sufficient evidence that benefit of goodwill is 20 year instead of 10 year (refer point 26.16-2).

Q3. NDA Inc. had two patents that have allegedly been infringed by competitors. After investigation, legal counsel informed NDA that it had a weak case on patent A34 and a strong case in regard to patent B19. NDA incurred additional legal fees to stop infringement on B19. Both patents have a remaining legal life of 8 years. How should NDA account for these legal costs incurred relating to the two patents?

a. Expense costs for A34 and capitalize costs for B19.

b. Expense costs for both A34 and B19.

c. Capitalize costs for both A34 and B19.

d. Capitalize costs for A34 and expense costs for B19.

Solution : (a)

As per para 59 of AS-26 (refer point 26.15), subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense when it is incurred unless:

a. 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

b. The expenditure can be measured and attributed to the asset reliably.

If these conditions are met, the subsequent expenditures should be added to the cost of the intangible asset.

Because NDA Inc. has a weak case on patent A34; the legal fees incurred in its defence should be expensed, rather than capitalized as an asset. This is in accordance with the doctrine of conservatism. As a result of this occurrence, NDA Inc. should also consider whether the patent would provide benefit to future periods. NDA Inc. has a strong case in regard to paten B19, however, and can expect to receive benefit in the future as a result of its successful defence. Consequently, the legal fees to stop infringement on B19 should be capitalized as an asset and answers (b), (c) and (d) are incorrect.

Q4. On January 1, 2010, NDA Corp. incurred organization costs/preliminary expenses of Rs. 24,000. What portion of the organization costs will NDA corp. defer to years subsequent to 2010?

Solution : (d)

As per para 56(a) of AS-26 (refer point 26.14), organization costs/preliminary expenses are those incurred in the formation of a corporation. Since uncertainty exists concerning the future benefit of these costs in future years, they are properly recorded as an expense in 2010.

Q5. NDA Ltd. is developing a new distribution system of its material, following are the costs incurred at different stages on research and development of the system

Year	Phase/Expenses	Amt.(Rs. In crores)
2006	Research	8
2007	Research	10
2008	Development	30
2009	Development	36
2010	Development	40

On 31-12-2010, NDA ltd identified the level of cost savings at Rs. 16 crores p.a. expected to be achieved by the new system over a period of 5 year, in addition this system developed can be marketed by way of consultancy which will

earn cash flow of 10 crores p.a. NDA Ltd. demonstrated that new system meet the criteria of asset recognition on 01-01-2008.

Determine the amount/cost which will be expensed and to be capitalized as intangible assets, presuming that no active market exist to determine the selling price of product i.e. system developed. System shall be available for use form 2011, for testing for impairment 10% discount factor can be taken.

Solution:

As per AS-26 research cost of Rs.. 8 and Rs. 10 crores to be expensed in respective years i.e. 2006 and 2007 (refer point 26.12).

The development expenses can be capitalized from the date the internally generated assets (new distribution system in this case) meet the recognition criteria on and from 01-01-2008. Therefore cost of Rs. 30 +36 + 40 =106 crores is to be capitalized as on intangible asset (refer point 26.12).

However as per para 62 of AS-26, the intangible should be carried at cost less accumulated amortization and accumulated impairment losses. (Refer point 26.16)

At the end of 2010 NDA ltd. should recognize impairment loss of Rs. 7.45 crores (106-98.54) and carry the 'new distribution system' (intangible asset) at 98.54 crores in Balance sheet as per calculation given below.

Impairment loss is excess of carrying amount of asset over recoverable amount. Recoverable amount is higher of the two i.e. value in use (discounted future cash inflow) and market realisable value of asset. (Refer AS- on impairment of asset).

The calculation of discounted future cash flow is as under assuming 10% discount rate.

Amt.(Rs. In crores)

Year	Cost saving	Inflow by Marketing the system	Total cash in flow	Discounted at 10%	Discounted cash flow
2011	16	10	26	0.909	23.634
2012	16	10	26	0.826	21.476
2013	16	10	26	0.751	19.526
2014	16	10	26	0.683	17.758
2015	16	10	26	0.621	16.146
					98.540

No amortization of asset shall be done in 2010 as amortization starts after use of asset, which is in 2011.

Accounting Standard - 28

Q1. NDA Ltd. acquired a machine for Rs. 32,00,000 on 30-11-2006. The machine has five-years life with Rs. 5,00,000 salvage value and was depreciated using straight-line method. On 31.-3-2009 a test for impairment reveals the following:-

a.	Present value of future cash flow	13,50,000
b.	Net selling price	15,40,000
c.	Salvage value estimated	Nil

Assuming loss for impairment is recognized for the year 31-3-2009. What should be the depreciation expenses for the year ended 31-3-2009 ?

Solution: Impairment loss for the year ended 31-3-2009

Carrying amount of machine {3200000-(3200000-5,00,000)/60X28}	19,40,000
Present value of future cash flow (Value in use)	13,50,000
Net selling price	15,40,000
Recoverable amount (higher of -15,40,000 and 13,50,000)	15,40,000
Impairment loss	
Carrying amount-recoverable amount	4,00,000
Revised carrying amount	15,40,000
Depreciation expense for the year 31-3-2010 {15,40,000 - Nil (Salvage value)X12/32}	5,77,500

Q2. Uttaranchal Industries Ltd. gives the following estimates of cash flows relating to fixed assets on 31-12-2005. The discount rate is 15%.

Year	Cash flow (Rs. in lakhs)
2006	2,000
2007	3,000
2008	3,000
2009	4,000
2010	2,000

Residual value at the end of 2010 500

Fixed Asset purchased on 1-1-2003 for	Rs. 20,000 lakhs
Useful life	8 years

Residual value estimated Rs. 500 lakhs at the end of 8 years. Net selling price Rs.10,000 lakhs.
Calculate on 31-12-2005:

a. Carrying amount at the end of 2005.
b. Value in use on 31-12-2005.
c. Recoverable amount on 31-12-2005.
d. Impairment loss to be recognized for the year ended 31-12-2005.
e. Revised carrying amount.
f. Depreciation charge for 2006.

Solution:

Computation of value in use (Rs. in lakhs)

Year	Cash flow	Discount as per 15%	Discounted cash flow
2006	2000	.870	1740
2007	3000	.756	2268
2008	3000	.658	1974
2009	4000	.572	2288
2010	2000+500 (residual value)	.497	1243
			9513

Value in use is Rs. 9,513 lakhs

Carrying amount -	
Original cost	20,000
Depreciation for3 years {(20,000-500) X3/8}	7,313
(For 2003, 2004&2005 on straight-line basis)	
Carrying amount on 31-12-2005	12,687
Net selling price (as given)	10,000
Recoverable amount (higher of 9,513 and 10,000)	10,000
Impairment loss	
Carrying amount - Recoverable amount	
12,687 - 10,000 =	2,687

Revised carrying amount = 12,687 - 2,687 = 10,000
Depreciation charge for 2006 - (10,000 - 500)/5 = 1,900

Q3. Reliance Industries Ltd. is a multi-product manufacturing company, its corporate office is housed in a building, as the area of building is large, the Reliance Industries Ltd. has let out 1/3 area of building at a monthly rent of Rs. 50 lakhs, the lease agreement with tenant is for next 5 years. Is the building cash-generating unit? If not what is the cash-generating unit of the building ?

Solution: As per para 66 of AS-28 the cash-generating unit is smallest group of asset that includes the asset and that generate cash flow from continuing use that are largely independent of the cash inflows from other assets (refer para 28.9 above) in the instant case the primary purpose of the building is to serve as a corporate asset supporting

Reliance Ltd. Multi-product manufacturing activities, therefore, the building as a whole cannot be considered to generate cash inflows which are largely independent of the cash flows from the company as a whole. The building is not held as an investment; therefore, it would be inappropriate to determine 'value in use' of the building based on future market rent.

Q4. Garhwal Industries Ltd. purchased a machine on 1-1-2009 for Rs. 50 lakhs having useful life of 5 years. On 31-12-2010 its carrying amount is Rs. 30 lakhs, due to fire, in a factory, there is some damage to machinery but stil it is working, its net selling price on 31-12-2010 is Rs. 22 lakhs. The machine does not generate independent cash inflows from use. The smallest group of asset that includes this machine generates cash inflows largely independent of other assets, the carrying amount of group of assets to which this machine belongs is Rs. 200 lakhs and the recoverable amount of group of assets (cash-generating unit) to which this machine belongs is Rs. 220 lakhs.

Calculate the impairment loss for the machine.

Solution: As per para 91(b) of AS-28. No impairment loss is recognized for the asset if the related cash-generating unit is not impaired. In this case, the related cash generating unit which is group of asset to which this damaged machine belongs is not impaired, as the recoverable amount is more than carrying amount of group of assets. Hence the machine even if damaged and net selling price is less than carrying amount should not be impaired (refer para 28.11 above).

Q5. An asset does not meet environment laws, which have been recently enacted. The asset has to be destroyed as per the laws. The asset is carried in the Balance Sheet at the year end at Rs. 60,000. Estimated cost of destroying it is Rs. 70,000. How is it to be accounted?

Solution: The value in use as well as selling rice is nil (since it has to be destroyed). Cost of disposal is Rs. 70,000. Therefore, an impairment provision of Rs. 60,000 will have to be recognized to write the asset down to nil. However, Para 40 of AS-28 states that when the amount estimated for an impairment loss is greater than its carrying amount, an enterprise should recognize a liability if and only if required by another accounting standard as per AS-29. Since liability is probable and can be reliably estimated, it should be provided. Hence, liability to the extent of Rs. 70,000 should be provided.

Accounting Standard - 29

Q1. Induga Company has at its financial year ended 31st March, 2010 fifteen law suits outstanding, none of which has been settled by the time the accounts are approved by the directors. The directors have estimated that the possible outcomes as below:

Result	Probability	Amount of loss
For first ten years		Rs.
Win	0.6	-
Lose-low damages	0.3	90,000
Lose-high damages	0.1	1,60,000
For remaining five cases:		
Win	0.5	-
Lose-low damages	0.3	60,000
Lose-high damages	0.2	95,000

The directors believe that the outcome of each case is independent of the outcome of all the others.

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss.

Solution: As per AS-29 (refer point 29.10) Contingent liability should be disclosed in financial statements if following conditions are satisfied:-

- There should be present obligation arising out of past event but not recognized as provision.
- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- The possibility of an outflow of resources embodying economic benefits is not remote.
- The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first 10 cases is 60% and for remaining, five cases 50%. In other words, the probability of losing is 40% or 50% respectively. As per the AS-29, we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note amount may be calculated as under:

Expected loss in first ten cases	=	Rs.90,000X0.3 + Rs. 1,60,000X0.1
	=	Rs. 43,000X10
	=	Rs. 4,30,000

Expected loss in remaining five cases	=	Rs. 60,000X0.3 + Rs. 95,000X0.2
	=	Rs, 37,000X5
	=	Rs. 1,85,000
Total Contingent Liability	=	Rs.4,30,000 + Rs.1,85,000
	=	Rs.6,15,000

Q2. NDA Ltd. (a Public Sector Company) gives consultancy and engineering services to its clients in year 2009-10. The Government has set up a commission to decide about the pay revision. The pay will be revised with respect 1-1-2005 based on the recommendation of the commission. The company makes the provision of Rs. 680 lakhs for pay revision in financial year 2009-10 on the estimated basis as the report of the commission is yet to come. As per the contracts with the client on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by these employees on each job.

The company disclose through notes to accounts.

"Salaries and benefits include the provision of Rs. 680 lakhs in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract when the actual payment is made".

Auditor's comments

"In violation of matching concept and Company's accounting policy, the company has not accounted for the income of Rs. 680 lakhs billable by it in respect of cost plus job on account of revision of pay scale. Even the expenditure of the job has been provided in accounts during the year 2009-10 this resulted in understatement of income and profit by Rs. 680 lakhs".

Were the comments of the auditors correct? Comment with explanation.

Solution: As per AS-29 (refer point No. 29.8-1) A potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter-claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists. In this case, the provision of salary to employees of Rs. 680 lakhs will be ultimately collected from the client as per the terms of the contract. Therefore, the liability of 680 lakhs is matched by the counter claim from the client. Hence, the provision for salary of employees should be made reducing the claim to be made from the client. It appears that the whole amount of 680 lakhs is recoverable from client and there is no significant uncertainty about the collection. Hence, the net charge to profit and loss account should be nil. The comments of the auditor regarding non-recognition of income of Rs. 680 lakhs is not as per AS-29 as well as per AS-9. Rs. 680 lakhs is not the revenue at present but only reimbursement of claim. However, the auditor comment is correct to the extent as this resulted in the under statement of income.

Q3. Board of Directors approved the financial account of year 2009-10 on 31st July, 2010. The following events occurred before the approval of financial accounts by Board of Directors. State how you would deal with this situation:

"The wages of the employees are revised retrospectively from Jan. 1, 2010. The agreement is signed on July 1, 2010.

The negotiations have been going on since Feb. 1, 2010. Due to this revision extra wages payable from Jan. 1, 2010 to March 31, 2010 was Rs 5,00,000". {Ans: Provision for Rs. 5,00,000}

Q4. In respect of a demand notice of Rs. 10,00,000 received from income-tax authorities. The company has lost the case in the High Court but an appeal is pending before the Supreme Court. In view of this company has not made provision in respect of the demand. Comment on non-provision of liability and non-disclosure of liabilities.
(Ans: Disclosure is must, however it is also possible to make provision instead of disclosure}

Q5. In the following case company, whose accounting year ended on 31st March, 2010 and whose accounts for that period were considered and approved by the respective Boards of Directors on 15th May, 2010. The following events took place after April, 2010 and you are required to state, with reasons, how each of the events would be dealt with in the financial statements for the year ended on 31st March, 2010. In case any disclosures are deemed necessary, you are required to draft the relevant notes also.

"A claim for damages of Rs. 10 lakhs for breach of patents and copyrights had been served on the company in January, 2010. The Directors sought competent legal advice on the eligibility of the claim and were advised that the claim was highly frivolous, without any basis, and would not survive even in the first trial court. The company, however, anticipates a long drawn legal battle and huge legal costs".

{Ans: No adjustment, no disclosure as per legal advice, but disclosure for estimated legal expenses}.

Examples on Accounting Standards

Example 1

Basis of Preparation of Accounts adopted and stated in the financial statements is as follows:

"The accounts are prepared under the Historical Cost Convention unless otherwise stated and generally on accrual method of accounting".

The policy adopted and stated in the financial statements does not meet the requirement of the accounting standard (AS 1). The accounting followed by the Institution is "hybrid system of accounting" ie a mix of accrual system of accounting and cash system of accounting. AS 1, Disclosure of Accounting Policies does not recognise hybrid system or cash system of accounting but recognises only and only accrual system of accounting.

In the circumstances when an institution has to account certain transactions on cash basis, it is always better to disclose the transactions accounted on cash basis and its likely impact on the surplus or deficit, as the case is.

Example 2

Diya University accounts income from students, affiliation fee from colleges and other incomes on accrual basis. But, it accounts interest on saving bank accounts and interest bearing investments as and when it is credited to the account. In other words, such incomes are accounted on cash basis. The university makes the disclosure in the Significant Accounting Policies attached to its annual financial statements.

Is the disclosure to the effect adequate and meets the requirements of Accounting Standard 1 - Disclosure of Accounting Policies.

Since it has not followed the fundamental accounting assumption of accrual, the auditors want to qualify the report. The management of Diya University, however, contends that AS-1 simply require a disclosure if a fundamental accounting assumption has not been followed, hence the report should not be qualified since the fact of accounting for his receipt from his students/ colleges, interest on saving bank accounts has been disclosed by way of notes to the accounts. Comment.

Answer

The reply is no. Disclosure to the effect is not adequate and also it does not meet the requirements of AS 1, Disclosure

of Accounting Policies because of the following reasons:

AS 1, Disclosure of Accounting Policies recognises three fundamental accounting assumptions that underline the preparation and presentation of financial statements. These accounting assumptions are:

a. **Going Concern:** The enterprise (in this case educational institution) is viewed as a going concern and accordingly, financial statements are prepared.

b. **Consistency:** It is assumed that accounting policies adopted shall remain consistent from one accounting period to another.

c. **Accrual:** revenues and costs are accrued, i.e., recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate.

The fundamental accounting assumptions are assumed to have been followed and if they have not been followed in preparation and presentation of financial statements. If any of the fundamental accounting assumption has not been followed in the preparation and presentation of financial statements, the reporting entity is required to disclose the same. As a matter of better reporting, it effect on the financial statements should also be disclosed.

In the present case it is not appropriate to account a part of income on cash basis and a part on accrual basis. The financial statements are not disclosing correct income of the institution for the year.

Every attempt should be made by the institution to record its incomes and expenses on accrual basis and if for any reason beyond its control, it cannot be so accounted only then disclosure should be made. It should be borne in mind that disclosure is not a remedy for inappropriate treatment.

Example 3

National Institute of Educational Excellence has accounted for its liability towards retirement benefits of its employee on cash basis as University's pension liability like that of the Government is not funded but follows the "Pay as you go" system of meeting the annual expenditure out of the annual revenue budget. However the other receipt is treated on accrual basis.

Since it has not followed the fundamental accounting assumption of accrual, the auditors intend to qualify the report. The management of Institute contends that AS-1, Disclosure of Accounting Policies require a disclosure if a fundamental accounting assumption has not been followed, hence, the report should not be qualified since the fact of accounting for retirement benefits on cash basis has been disclosed by way of note in the financial statements. Comment.

Answer

AS 1, Disclosure of Accounting Policies recognises three fundamental accounting assumptions that underline the preparation and presentation of financial statements. These accounting assumptions are:

a. **Going Concern:** The enterprise (in this case educational institution) is viewed as a going concern and

accordingly, financial statements are prepared.

b. **Consistency:** It is assumed that accounting policies adopted shall remain consistent from one accounting period to another.

c. **Accrual:** revenues and costs are accrued, i.e., recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate.

The fundamental accounting assumptions are assumed to have been followed and if they have not been followed in preparation and presentation of financial statements. If any of the fundamental accounting assumption has not been followed in the preparation and presentation of financial statements, the reporting entity is required to disclose the same. As a matter of better reporting, it effect on the financial statements should also be disclosed.

In the present case it is not appropriate to follow the practice of accounting retirement benefits on the principle "Pay as you go" as it is accounting expenses on cash basis. The Institute should obtain actuarial valuation report and provide for such expenses every year. The adoption of this practice will result in showing correct surplus or deficit i.e. excess of income over expenditure or excess of expenditure over income.

The institution should record the expense on accrual basis. It should be borne in mind that disclosure is not a remedy for inappropriate treatment.

Example 4

Megha University of Engineering has a total receipt of Rs. 800Lacs, for the current year which includes a sum of Rs. 16 lacs being royalty receivable for supply of technical know-how to White and Brown Ltd. Greece. As per the agreement, the amount is to be received in Euros. However, White and Brown Ltd. is not able to remit the amount because of the restrictions imposed by the Government on remittances of foreign exchange.

Is it appropriate for Megha University of Engineering to recognise revenue in the current year being the royalty receivable from White and Brown Ltd.?

Answer

No, it is not appropriate for Megha University of Engineering to recognise revenue in the current year since it is not certain that the revenue will be realised. It should be postponed to the year when it is certain that income will be received.

In the present situation, AS 9, Revenue Recognition should be considered. As per AS 9, following two conditions must be satisfied before revenue can be recognised:

i. Revenue should be measurable;

ii. At the time of sale or the rendering of the service, there should be a reasonable certainty of ultimate collection.

While the revenue is measureable, the second condition is not met. The ultimate collection of royalty is not certain because of the very unstable financial condition of the country. It is not certain when the ban on remittances will be lifted by the government.

Example 5

Legal Institute of Law has received 10,000 membership subscriptions for library, during the year 2011-12. Under the scheme the subscribers entitled to receive magazine on legal issues and updates through electronic media for three years. The entire subscription has been treated as revenue for the current year. Comment.

Answer:

Treatment adopted by the institute is not correct. Revenue should be recognised on a straight line basis. According to the AS-9 revenue should be recognised following Proportionate Method when the performance consist of the execution of more than one act but the performance of unfinished acts is not such so as to act as a hindrance in revenue recognition for the acts already accomplished.

Example 6

Normally institutions have adopted policy of charging depreciation for the full year on the assets purchased during the accounting period. Depreciation plays an important part in determining surplus or deficit of an Institution. It is therefore, necessary that correct depreciation be provided in the books of accounts. AS 6, Depreciation Accounting requires that an asset should be depreciated over its useful life, and the useful life of an asset starts from the day it is put to use and not earlier. Depreciation when charged for the full year on assets purchased during the year means that depreciation is charged for the period when the Institution was not even the owner of that asset. In other words, excess depreciation is debited to the Income & Expenditure Account, which has adverse effect on the asset value. It also means that assets are shown at lower book value.

Example 7

Accounting of Gifted Fixed Assets

Fixed assets gifted to the university/institutions are merged with the fixed assets of the university and depreciation is charged at the rates applicable to the respective asset.

It would have been more appropriate if the accounting policy also stated what is basis of valuation of fixed asset gifted to the university/institution.

Example 8

Receipts and Payments Account vs. Cash Flow Statement

Although most of the universities/institutions prepare Receipts and Payments Account, yet it cannot be a substitute of Cash Flow Statement. Cash Flow Statement shows the sources and uses of cash and cash equivalents under operating activities, investment activities and financing activities. Thus, it shows whether the university/institution is earning adequate surplus from its operating activities (i.e. revenue producing activities).

Cash Flow from Operating Activity throws light on the fact whether there is adequate surplus and if there is a deficit, what is the extent thereof.
Cash Flow from Investing Activities throws light on amount invested and returns thereon by way of interest and dividend.
Cash Flow from Financing Activities throws light on the sources of funds for the university / institution.

MCQ on Accounting Standards

MCQs

AS 1

1. Fundamental accounting assumptions are:
   a. accrual
   b. going concern
   c. consistency
   d. all of the above
   e. none of the above

2. An accounting policy can be changed provided:
   a. it is required by statute
   b. it is required for compliance within accounting standards
   c. the change would result in more appropriate presentation of financial statements
   d. in all the above situations
   e. none of the above

3. In the following areas different accounting policies can be adopted for preparation and presentation of financial statements:
   a. valuation of inventory
   b. treatment of government grants
   c. treatment of expenditure during the construction period
   d. all of the above
   e. none of the above

AS 3

4. Which of the following method can be used by listed enterprises for preparation and presentation of cash flow statement:
   a. indirect method
   b. direct method
   c. both (a) and (b) are permissible

d. none of the above

5. Cash and cash equivalents include:
   a. cash in hand and demand deposits with banks
   b. term deposits with banks
   c. short-term highly liquid investments readily convertible into known amount of cash which are subject to an insignificant risk of changes in value
   d. both (a) and (c)
   e. none of the above

6. Which of the following cash flows are excluded from the cash flows that arise from financing activities:
   a. cash receipts from disposal of shares
   b. cash receipts from disposal of intangible assets
   c. cash payments for future contracts
   d. all of the above
   e. none of the above

7. Which of the following is not a cash flow arising from operating activities:
   a. cash receipt from royalties
   b. cash payment to employees
   c. cash payment relating to swap contracts, if the contract is held for trading purposes
   d. all of the above
   e. none of the above

8. Taxes on income should be classified as:
   a. operating activities
   b. financing activities
   c. investing activities
   d. operating activities, unless they can be specifically identified with financial and investing activities
   e. none of the above

AS 6

9. Amount of depreciation depends upon:
   a. historical cost
   b. expected useful life
   c. estimated residual value
   d. all of the above
   e. none of the above

10. The historical cost of a plant and machinery has undergone a change due to increase in the long-term liability on account of exchange fluctuations. Depreciation should be provided on the revised unamortised depreciable amount:
    a. prospectively over the residual useful life of the asset

b. retrospectively over the total useful life of the asset
c. both (a) and (b) are permissible
e. none of the above

11. An asset was acquired for Rs. 50 lakhs five years ago. The asset has been revalued in the current reporting period at Rs. 40 lakhs. Depreciation provided till date is Rs. 20 lakhs. The total useful life of the asset was 10 years. Depreciation charged for the current year will be:
    a. Rs. 8 lakhs
    b. Rs. 6 lakhs
    c. Rs. 4 lakhs
    d. Rs. 12 lakhs
    e. none of the above

AS 9

12. Which of the following method is not allowed by AS 9 for revenue recognition:
    a. completed service contract method
    b. proportionate completion method
    c. both (a) and (b)
    d. none of the above

13. Revenue from sale of goods should be recognised when:
    a. all significant risks and rewards of ownership have been transferred to the buyer
    b. the seller retains no effective cost of the goods transferred to a degree usually associated with ownership
    c. no significant uncertainty exists regarding the amount of revenue
    d. all of the above
    e. none of the above

AS 10

14. Machinery spares that can be used only in connection with a specific item of fixed assets and having an irregular use:
    a. should be expensed off immediately
    b. should be written off over a period not exceeding their own useful life
    c. should be written off over a period not exceeding the useful life of the principal asset
    d. none of the above

15. The cost of a fixed asset acquired in an exchange for dissimilar asset is determined by reference to:
    a. the fair market value of the asset acquired
    b. the fair market value of the consideration given
    c. (a) or (b) whichever is more clearly evident
    d. none of the above

16. An expected loss on a fixed asset retired from active use and held for disposal:

a. should be recognised immediately in the profit and loss account
b. should be recognised at the time of actual disposal
c. should be recognised systematically over the period acquired for disposal
d. none of the above

17. An asset which was previously revalued has been disposed of for a consideration of Rs. 15 lakh, the disposal expenses being Rs. 1 lakh. The net book value of the asset at the time of sale is Rs. 20 lakhs. An amount of Rs. 4 lakhs exist in the revaluation reserve relating to the asset. The loss on disposal should be:
    a. fully charged to profit and loss account
    b. an amount of Rs. 4 lakhs should be charged to revaluation reserve and Rs. 2 lakhs to profit and loss account
    c. should be equally charged to revaluation reserve and profit and loss account
    d. none of the above

AS 12

18. Government grants should be included in accounts when:
    a. there is reasonable assurance that the enterprise will comply with the attached conditions
    b. such benefits have been earned by the enterprise and it is reasonably certain that the ultimate collection will be made
    c. when both (a) and (b) are satisfied
    d. none of the above

19. Government grants related to revenue are:
    a. credit to profit and loss account
    b. deducted from the related expense
    c. both (a) and (b) are allowed
    d. none of the above

20. Government grants that become refundable should be treated as:
    a. extraordinary items
    b. prior period items
    c. change in accounting estimate
    d. none of the above

Answers to MCQs

MCQ 1: (d)

MCQ 2: (d)

MCQ 3: (d)

MCQ 4: (a)

MCQ 5: (d)

MCQ 6: (d)

MCQ 7: (e)

MCQ 8: (d)

MCQ 9: (d)

MCQ 10: (a)

MCQ 11: (a)

MCQ 12: (d)

MCQ 13: (d)

MCQ 14: (c)

MCQ 15: (c)

MCQ 16: (a)

MCQ 17: (b)

MCQ 18: (c)

MCQ 19: (c)

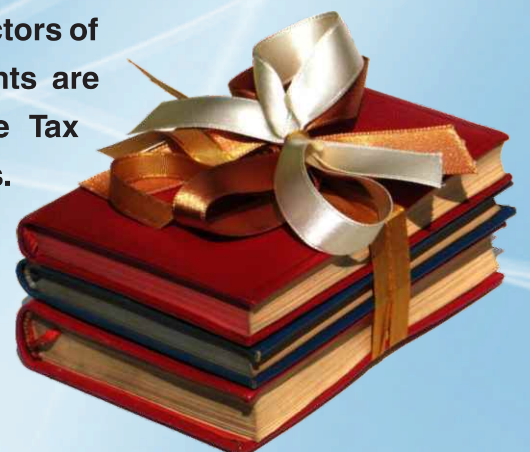
MCQ 20: (a)

The Institute of Chartered Accountants of India

The Institute of Chartered Accountants of India (ICAI) is a statutory body established by the Chartered Accountants Act, 1949 for the regulation of the profession of Chartered Accountants in India. During its more than six decades of existence, ICAI has achieved recognition as a premier accounting body not only in the country but also globally, for maintaining highest standards in technical, ethical areas and for sustaining stringent examination and education standards. ICAI is now the second largest accounting body in the world.

ICAI has its Headquarters at New Delhi with five Regional Offices at Mumbai, Chennai, Kanpur, Kolkata and New Delhi. It presently has 128 branches spread all over the country. In addition, it has also set up 21 chapters outside India and an overseas office in Dubai.

Currently, over one million students are pursuing the Chartered Accountancy course and the total membership of ICAI is more than 2,00,000. Out of the total members, nearly 50% are in Practice and the rest are in employment. Among the members in Government, judiciary, industry, banks, financial institutions, private enterprises, etc. a significant number of members had occupied/occupy eminent positions in their respective organisations such as Chairperson of regulatory bodies, Chairperson of banks and insurance companies, Chairperson & Managing Directors of reputed enterprises and Executive Directors of various enterprises and organisations. Chartered Accountants are also serving as Vice Presidents and Members of Income Tax Appellate Tribunals besides being in IAS, IPS and IRS cadres. The members of the ICAI are getting recognition in foreign countries as well. It is evident from the positions they are occupying in all big companies across the world. Presently, there are about 12,000 members working abroad and occupying key positions.



www.icai.org

The Institute of Chartered Accountants of India

ICAI Bhawan, Indraprastha Marg, P. B. No. 7100

New Delhi - 110 002, INDIA