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# INDIAN ACCOUNTING STANDARDS

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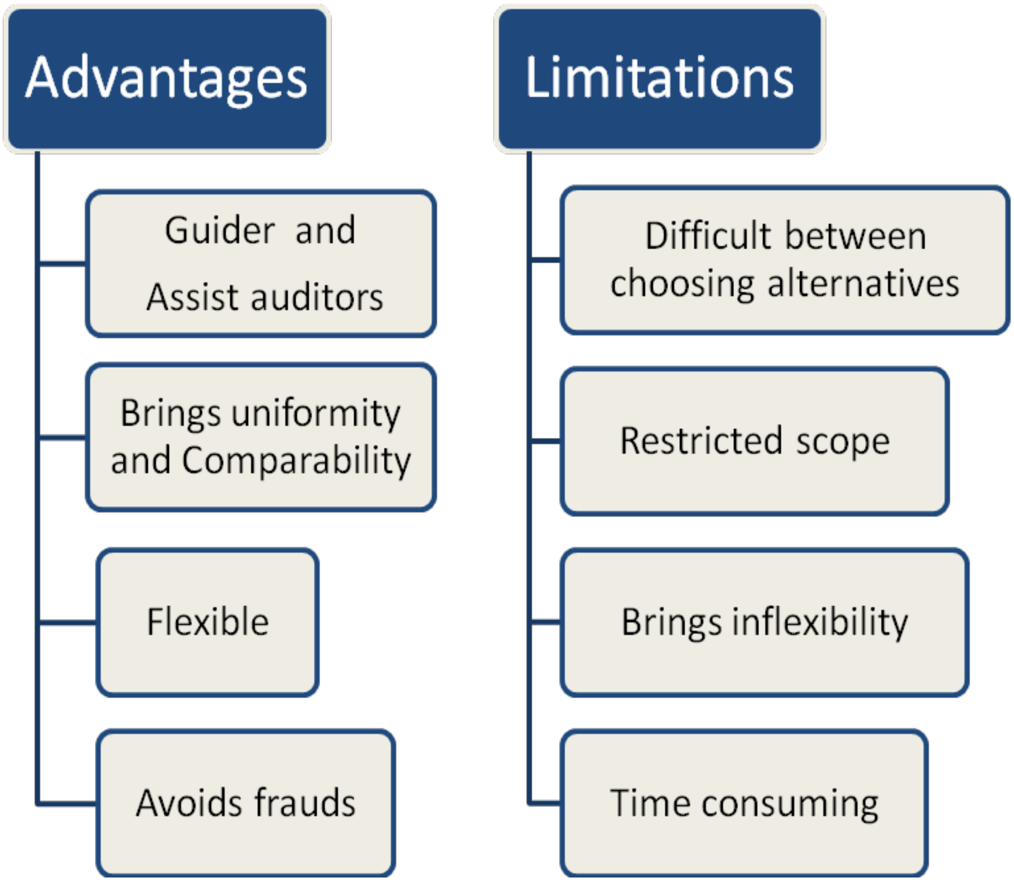
# MEANING

- Accounting standards is a common set of principles, standards and procedures which specify how an organization transactions and events are to be recorded, recognised, measured and disclosed in financial statements.
- Accounting standards are authoritative standards (means binding to all the companies) for financial reporting and are the primary source of generally accepted accounting principles (GAAP).
- The objective of the accounting standards is to ensure that the financial statements of the company are easily understandable to all stakeholders (like creditors, debtors, shareholders, government etc). Because all companies follows same set of accounting rules which ensures information about the company is relevant and accurate.
- Accounting standards improve the transparency of financial reporting in all countries. As accounting standards followed by companies across the world are almost similar.

# NEED FOR ACCOUNTING STANDARDS

- Accounting is an information system and its main aim is to provide financial information to a number of parties such as investors, management, creditors, government etc.
- Such information is provided through a set of financial statements such as profit and loss account, balance sheet, and cash flow statement etc.
- The set of financial statements of a company should depict a true and fair view of its operating results and financial position.
- There is need to harmonise and standardise the different accounting policies so that financial statements become consistent and comparable.
- Certain standard must be followed for preparing the financial statements, so that there is minimum ambiguity and uncertainty about the figures contained in financial statement.

# ADVANTAGES AND LIMITATIONS OF ACCOUNTING STANDARDS




## Advantages of Accounting Standards

- **Guider** - Accounting Standards serve as a guide for the whole accounting system. Accounting standards govern the manner in which financial statements are prepared and presented.
- **Mandatory to follow** – All companies must have to follow the accounting standards; these guidelines are not optional in nature.

- **Brings uniformity** - It sets the same guidelines and standards for every business for accounting treatments. Companies are required to prepare & present financial statements as per the same accounting standards.

  For example, each company has to prepare its balance sheet according to format given in schedule III of companies act.

- **Flexible** - In many cases, companies are free to adopt any method from the option of different accounting practices. As in case of accounting for depreciation companies can adopt any depreciation method (straight line or written down method) according to their will.

- **Avoids frauds and data manipulation**- It aims at reducing the errors & chances of manipulation of data by management. Companies are strictly bound to follow the guidelines of accounting standards.

- **Comparability** - All companies follow the same guidelines for the same accounting treatments. This makes the comparison between financial statements possible and easy.

- **Assist auditors** - These standards help auditors in verifying the correctness of company accounts. Accounting standards provides all accounting rules and regulations to be followed in a written format that enables auditors to follow uniform practices

## Limitations of Accounting Standards

There are a few limitations of Accounting Standards as well. The regulatory bodies keep updating the standards to restrict these limitations.

- **Difficulty between Choosing Alternatives -**There are alternatives for certain accounting treatments or valuations. Like for example, stocks can be valued by LIFO, FIFO, weighted average method, etc. So, choosing between these alternatives is a tough decision for the management. The AS does not provide guidelines for the appropriate choice.
- **Restricted Scope -** Accounting Standards cannot override the laws or the statutes. They have to be framed within the confines of the laws prevailing at the time. That can limit their scope to provide the best policies for the situation.
- **Brings inflexibility and rigidity -** Accounting standards basically establish all principles and rules for accounting treatment. Every company is required to follow the same principles constantly

- **Time consuming -** Implementation of accounting standards requires many steps to be followed to prepare financial report. It makes the process of preparing financial statements complex & time-consuming

# INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

- International Financial Reporting Standards (IFRS) is a set of accounting standards that are globally accepted issued by International Accounting Standard Board (IASB).
- It explains how different types of business transactions and events should be reported in financial statements.
- It includes guidelines and interpretations approved by the International Accounting Standard Board.
- IFRS are drafted in a clear and simple language and are easy to understand and apply.
- It brings the consistency to the field of accounting. As maximum companies all over the world follow IFRS.
- It permits international comparison of firm's financial statement possible. It helps global investors and creditors to compare financial statements without adjusting for national accounting difference.
- Under the IFRS, the historical concept of recording the fixed assets has been replaced by current cost system for a more accurate and realistic financial position of the business enterprise.

# INDIAN ACCOUNTING STANDARDS BOARD

- The Institute of Chartered Accountants of India (ICAI) being the premier accounting body in the country had set up the **Accounting Standards Board (ASB)** on 21st April, 1977, with key objective of formulating Accounting Standards to harmonise varied accounting policies.

- ASB is a committee which consists of representatives from government department, academicians, other professional bodies viz. ICAI, representatives from ASSOCHAM, CII, FICCI, etc.

- The function of the board is to review the Accounting Standards on the regular basis from the point of view of changed conditions, practical challenges and implementation experience, if any, and revises the same appropriately.

- It takes adequate steps to enhance knowledge of the members and other stakeholders for proper implementation of Accounting Standards by conducting workshops and seminars.

- It collaborate and develop mutually beneficial partnerships with other national standard-setters and various consultative/advisory forums of IFRS Foundation such as Asian-Oceanian Standard-Setters Group(AOSSG), Emerging Economies Group (EEG), International Forum of Accounting Standard-setters (IFASS), Accounting Standards Advisory Forum (ASAF), IFRS Advisory Council, Financial Accounting Standards Board of US (FASB), European Financial Reporting Advisory Group (EFRAG) etc.

- It provide time to time interpretations and guidance to support implementation of Accounting Standards, including publishing education material, guidance notes, technical guides, implementation guide, e-learning tools, etc

# ACCOUNTING STANDARDS IN INDIA

- Now India will have **two sets of accounting standards**

  1. Existing accounting standards under Companies (**Accounting Standard) (AS)** Rules, 2006

  2. International Financial Reporting Standards (IFRS) converged **Indian Accounting Standards (Ind AS)**.

- Convergence means to achieve harmony or co-ordination with IFRS and not complete adoption. There are modifications in IFRS where necessary.

- Before the introduction of Ind AS, financial statements were prepared on the basis of Accounting Standards (AS) which were not in line with the standards and principles applicable globally (IFRS). Due to this investors were not able to assess and compare the financial position of Indian companies with other global companies.

- In make financial statements uniform, Ind AS were introduced which are converged form of IFRS (global standards).
- Moreover, introduction of Ind AS will bring consistency in the accounting practices and principles followed by companies in India and other companies across world, leading to enhanced accessibility and acceptability of financial statements by global investors.

| **Bases** | **Ind-AS (Indian Accounting Standards as converged with IFRS)** | **Indian Accounting Standards** |
| --- | --- | --- |
| Basis | Ind AS are **principal based**. It reports only the essence of each small transaction which is finally audited.<br><br>In principle based approach to regulation, outcomes and principles are set and the controls, measures and procedures are left for each organisation to determine. | AS are **rule based** which are long, complex and with avoidable details.<br><br>Rule based approach to regulation prescribe in detail or gives a set of rules, how to record each and every thing. |
| Applicability | Ind-AS will be applicable in phases to mainly large companies | AS applicable to not only the companies, but to other entities as well. To the companies, notified standards under company rules are applicable and for other entities, AS published by ICAI are applicable |
| Guidance | Ind-AS generally use the word – "shall" in its guidance, which makes it stricter. | AS generally use the word "Should". This is more advisory in nature. |
| New Standards | Ind-AS provide guidance on various transactions like agriculture, business combinations etc. | These guidance were not existing in AS. |
| Fixed assets | Ind AS are based on the concept of fair value of fixed assets | AS follow the old concept of historical cost |

| | | |
|---|---|---|
| Multiple reporting | Ind AS will ensure that there is no multiple reporting for companies located in different countries that use one set of financial statements in the home country and the other set for the foreign country | Multiple reporting has to be done when financial statements are based on the accounting standards mainly because of historical cost concept. |

- The main reason for not full conversion with IFRS is that accounting standards are meant for implementation by entities operating in a particular territory. Therefore standard settlers take into consideration the environment in which entity operates (including the cultural environment and customs) and competencies of the auditors of the financial statements and that of analyst and investors.
- A global standard like IFRS can't consider environment and capability available in each country. Therefore, national standard settlers modify IFRS if required, however deviation are kept at the minimum because if subsidiaries of multinational companies which are operating in different territories follow different accounting policies then preparation of consolidated financial statements become difficult.

## Phases of adoption

MCA has notified a phase-wise convergence to IND AS from current accounting standards. IND AS shall be adopted by specific classes of companies based on their Net worth and listing status.

1. **Phase I**

Mandatory applicability of IND AS to all companies from 1st April 2016, provided:

- It is a listed or unlisted company
- Its Net worth is greater than or equal to Rs. 500 crores*

*Net worth shall be checked for the previous three Financial Years (2013-14, 2014-15, and 2015-16).

2. **Phase II**

Mandatory applicability of IND AS to all companies from 1st April 2017, provided:

- It is a listed company or is in the process of being listed (as on 31.03.2016)
- Its Net worth is greater than or equal to Rs. 250 crores but less than Rs. 500 crores (for any of the below mentioned periods).

Net worth shall be checked for the previous four Financial Years (2014-14, 2014-15, 2015-16, and 2016-17)

3. **Phase III**

Mandatory applicability of IND AS to all Banks, NBFCs, and Insurance companies from 1st April 2018, whose:

- Net worth is more than or equal to INR 500 crores with effect from 1st April 2018.

IRDA (Insurance Regulatory and Development Authority) of India shall notify the separate set of IND AS for Banks & Insurance Companies with effect from 1st April 2018. NBFCs include core investment companies, stock brokers, venture capitalists, etc. Net Worth shall be checked for the past 3 financial years (2015-16, 2016-17, and 2017-18)

4. **Phase IV**

All NBFCs whose Net worth is more than or equal to INR 250 crores but less than INR 500 crores shall have IND AS mandatorily applicable to them with effect from 1st April 2019.

**Note:** If IND AS become applicable to any company, then IND AS shall automatically be made applicable to all the subsidiaries, holding companies, associated companies, and joint ventures of that company, irrespective of individual qualification of such companies.

# IND AS 2: VALUATION OF INVENTORIES

- The objective of this Standard is to determine the value at which inventories are carried in the financial statements.
- This standard provide the guidance for determining the cost of inventories and for subsequent recognition as an expense, including any write-down to net realisable value
- It provides guidance on the techniques for the measurement of cost.

## Meaning of Inventories

- Inventories are assets
  1. Held for sale in the ordinary course of business (finished goods)
  2. In the process of production for such sale (work in progress)
  3. In the form of materials or supplies to be consumed in the production process or in the rendering of services (raw material)

*For example, for shirt manufacturer the inventories will include*

*cloth material (Raw material)*

\+

*Shirts which are not completed (work in progress)*

\+

*Completed shirts ready for sale (Finished good)*

- This **standard does not applies to**
  1. Financial instruments (example – shares , debentures, bonds, etc) (Ind AS 32, Financial Instruments: Presentation and Ind AS 109, Financial Instruments)

2. Biological assets (i.e. living animals or plants) related to agricultural activity and agricultural produce at the point of harvest (Ind AS 41, Agriculture).

3. Work in progress arising under construction contracts including directly related service contracts (Ind AS 11 Construction Contracts)

## Measurement of Inventories

**Lower of Cost and Net Realisable Value (NRV)**

## Cost

Cost of inventories comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present condition and location.

### COST OF INVENTORY

**COSTS OF PURCHASE**

PURCHASE PRICE
+
TAXES AND DUTIES
OTHER THAN REFUNDABLE
+
FREIGHT INWARD
-
TRADE DISCOUNTS

**COSTS OF CONVERSION**

DIRECT LABOUR
+
SYSTEMATIC ALLOCATION OF FIXED AND VARIABLE PRODUCTION OVERHEADS

**OTHER COSTS**

COST OF DESIGNING PRODUCT FOR CUSTOMIZED PRODUCT

- **Costs of purchase –**
  - The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services.
  - Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

- **Costs of conversion –**
  - The costs of conversion of inventories include costs directly related to the units of production, such as direct labour.
  - They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods.
    - **Fixed production overheads** are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory, buildings and equipment, and the cost of factory management and administration.
    - The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities.
    - Normal capacity is the production expected to be achieved on average over a number of period under normal circumstances.
    - **Variable production overheads** are those indirect costs of production that vary with the volume of production, such as indirect materials and indirect labour.
    - Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.
  - In case of a **Joint / By-product** (two or more products are manufactured simultaneously) where cost of conversion is each product is not separately identifiable, they are allocated between the products on a rational and consistent basis.

For example, Based on sale value of the products either at the stage of separation or on completion of production, etc.

- When by-products are considered immaterial or of a negligible value, they are often measured at NRV and this value is deducted from the cost of the main product.

➢ **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, the costs of designing products for specific customers in the cost of inventories.
- An entity may purchase inventories on **deferred settlement terms**. When the arrangement effectively contains a financing element, that element, for example a difference between the purchase price for normal credit terms and the amount paid, is recognised as interest expense over the period of the financing.

➢ Examples of **costs excluded from the cost of inventories** and recognised as expenses in the period in which they are incurred are:

(a) Abnormal amounts of wasted materials, labour or other production costs;

(b) Storage costs, unless those costs are necessary in the production process before a further production stage;

(c) Administrative overheads that do not contribute to bringing inventories to their present location and condition; and

(d) Selling costs.

(e) Borrowing cost (but Ind AS 23, Borrowing Costs, identifies limited circumstances where borrowing costs are included in the cost of inventories)

➢ **Cost of inventories of a service provider**

- To the extent that service providers have inventories, they measure them at the costs of their production.

- These costs consist primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel, and attributable overheads.

- The cost of inventories of a service provider **does not include**

  (a) Profit margins or non-attributable overheads that are often factored into prices charged by service providers.

  (b) Labour and other costs relating to sales and general administrative personnel are not included but are recognised as expenses in the period in which they are incurred.

- **For example**, your firm provides management services to other business. You record staff time on time sheets. At the end of the period, you have some unbilled work in progress of 485 hours for various clients. These should be valued as inventory at the cost of salaries, social security and pensions

## Techniques for the measurement of cost

The technique for measurement of the cost depends on the type of industry and the method that best approximates the cost.

| **Standard cost** | **Retail Method** |
|---|---|
| It takes into consideration the normal levels of material, supplies, labour and efficiency and capacity utilisation. | The cost of inventory is measured by reducing the sales value by an appropriate percentage of gross margins. |
| It is applicable in manufacturing business | It is applicable in retail business |

## Cost formulas

➢ The cost of inventories of items that are **not ordinarily interchangeable** i.e. the products which are customized according to demand (example aircrafts, ships) and goods or services produced and segregated for specific projects should be assigned by specific identification of their individual costs.

- For other inventories (**ordinary interchangeable**), cost can be assigned by using the first-in, first-out (FIFO), or weighted average cost formula, whichever reflects the fairest possible approximation to the cost.
- The **FIFO formula** assumes that the items of inventory that were purchased or produced first are sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced.

  Under the **weighted average cost formula**, the cost of each item is determined from the weighted average of the cost of related items at the beginning of a period and the cost of related items purchased or produced during the period.

## Net Realisable Value (NRV)

- NRV is the estimated selling price in ordinary course of business less the estimated costs of completion (for WIP) and the estimated costs necessary to make the sale.
- NRV is the amount which an entity expects to receive from the sale of inventory.
- The practice of writing inventories down below cost to net realisable value is consistent with the view that assets should not be carried in excess of amounts expected to be realised from their sale or use.
- Net realisable value is estimated on the basis of the reliable evidence available at the time of estimation.
- Estimates also take into consideration the purpose for which the inventory is held. For example, if the inventory held is for a particular contract then the net realisable value is based on the contract price.
- For **NRV of raw material**

  1. **If NRV of finished goods is greater than cost of finished goods** (it means company is expecting to sell the finished goods at higher price than cost, it will record finished goods at cost (lower of NRV and Cost)). Then measure the raw material at cost. Materials and other supplies held for use in the production of

inventories are not written down below cost because if company can sell finished goods above cost than it means it assume that NRV of raw material will also be higher than cost.

2. **If NRV of finished goods is lower than cost of finished goods** (it means company is expecting to sell the finished goods lower than cost, means it will record finished goods at NRV (lower of NRV and Cost)). Then the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

- If in future, firm believes that value of the inventory which was earlier written down below cost at NRV has increased because of changed economic circumstances, the amount of the write-down will be reversed.

  For example, if firm has recognised inventory at Rs 800 (lower of cost (Rs 1000) and NRV (Rs 800)). Suppose next year due to rise in selling price, NRV becomes Rs900. Then firm will recognise inventory at Rs 900 (lower of cost (Rs 1000) and NRV (Rs 900))

## Recognition as expense

- When inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised.

  For example, if all goods are sold

Profit and loss account

| | | | | |
|---|---|---|---|---|
| Recognized as expense | Purchases | 1000 | Sales | 1200 |
| | Gross Profit | 200 | | |
| | | 1200 | | 1200 |

- The amount of any write-down of inventories to net realisable value and all losses of inventories shall be recognised as an expense in the period the write-down or loss occurs.

  For example, if no goods are sold and NRV (Rs 800) is lower than cost (Rs 1000)

Profit and loss account

| | | | |
|---|---|---|---|
| Purchases | 1000 | Closing stock | 800 |
| | | Gross loss | 200 |
| | 1000 | | 1000 |

Recognized as expense

- If in future NRV increase then it shall be recognised as an income in the period in which the reversal occurs.

  For example, if in above case NRV will increased to Rs 900 in next year

Profit and loss account

| | | | |
|---|---|---|---|
| Opening stock | 800 | Closing stock | 900 |
| Gross profit | 100 | | |
| | 900 | | 900 |

Recognized as income

## Disclosure

The financial statements shall disclose: -

- The accounting policies adopted in measuring inventories, including the cost formula used
- The total carrying amount of inventories and the carrying amount in classifications appropriate to the entity
- The carrying amount of inventories carried at fair value less costs to sell

- Amount of inventories recognised as an expense
- The amount of any write-down of inventories recognised as an expense
- The amount of any reversal of any write-down that is recognised as a reduction in the amount of inventories recognised as expense
- Circumstances or events that led to the reversal of a write-down of inventories
- Carrying amount of inventories pledged as security for liabilities.

# IND AS 7: STATEMENT OF CASH FLOWS

## Introduction

- The cash flow statement is a financial statement which shows the amount of cash and cash equivalent coming in and going out of the business.
- **Cash** comprises of cash in hand and demand deposits (A demand deposit is money deposited into a savings and current bank account of the firm, which can be withdrawn at any time)
- **Cash equivalents** are short term, highly liquid investments that can be easily convertible into cash. There is very less risk of change in the value of these investments.
- **Cash flows** are inflows and outflows of cash and cash equivalents.
- Cash flows of the business are classified into three categories


**Cash Flow Statement**

| Particulars | Amount |
|---|---|
| (A) Cash flows from operating activities<br>(B) Cash flows from investing activities<br>(C) Cash flows from financing activities | XXX<br>XXX<br>XXX |
| Net increase/decrease in cash and cash equivalents (A + B + C) | XXX |
| Add - Cash and cash equivalents at the beginning | XXX |
| Cash and cash equivalents at the end | XXX |

## Cash flows from operating activities

- Operating activities are the core revenue producing activities of the firm. Activities that are part of the main business of the company. **Example** - Sale and purchase of goods for a trading firm, accepting deposits and lending money for the banks.
- Let us understand with the help of example of Britannia Industries Limited. It is an Indian food and beverage company. If company is buying raw material like wheat, sugar etc and selling finished goods like bread, biscuits etc; all these activities are considered as operating activities.

  If the same company takes loan from bank or issue shares or buy a new plant and machinery, then these activities are not considered as operating activity.
- There are two different methods available for reporting cash flows from operating activities

  1) Direct method

  2) Indirect method

### Direct Method

Under the direct method, the major classes of gross cash receipts and gross cash payments are disclosed by the firm. All cash related transactions are directly taken from the books of accounts. All cash inflow transactions are added and all cash outflow transactions are subtracted.

- ✓ Cash Sales/ Cash Purchases
- ✓ Collection from Debtors/ payment to creditors
- ✓ Expenses paid (Salaries, wages etc)
- ✓ Tax Paid
- ✓ Collection from Bills Receivable & Bills Payable

## Indirect method

Under the indirect method, we use profit and loss account for finding cash from operating activities. As statement of profit and loss incorporates the effects of all operating activities of an enterprise. However, Statement of Profit and Loss is prepared on accrual basis (and not on cash basis). Moreover, it also includes certain non-operating items (such as interest paid, profit/loss on sale of fixed assets, etc) and non-cash items (such as depreciation, goodwill written-off, dividend declared, etc.). Therefore, it becomes necessary to adjust the amount of net profit/loss as shown by Statement of Profit and Loss for arriving at cash flows from operating activities.

The basic idea is, from net profit

- Add back the non cash and non operating expenses which are subtracted while calculating net profit in P&L A/c

- Subtract non operating incomes which are added while calculating net profit in P&L A/c

- Add decrease in current asset and increase in current liability

  **Example** –1) Decrease in bills receivable means cash received from debtors, so there is cash inflow, add this to net profit

  2) Increase in bills payable means there is credit purchases done by firm, which is initially subtracted while calculating net profit, it is non cash transaction. So add back that amount

- Subtract increase in current assets and decrease in current liability

  **Example** - 1) Increase in bills receivable means there is credit sales done by the firm, which is initially added while calculating net profit, it is non cash transaction. So subtract that from net profit.

  2) Increase in inventory means firm had bought inventory. It is cash outflow. So subtract the amount from the net profit.

3) Decrease in bills payable means firm had paid that amount to creditors. So it is cash outflow, subtract this from the net profit

- Subtract the income tax because it is cash outflow

| **Particulars** | **Amount** |
|---|---|
| **Net Profit/Loss before Tax and Extraordinary Items** | **XXX** |
| **Add** - Deductions already made in P&L A/c of **Non-cash items** (Depreciation, Goodwill to be Written-off) | + XXX |
| **Add** - Deductions already made in P&L A/c of **Non-operating items** (Interest paid) | + XXX |
| **Less** - Additions (incomes) made in P&L A/c of **Non-operating items** (Dividend received, Profit on sale of Fixed Assets) | ( - XXX) |
| **Operating Profit before Working Capital changes** | **XXX** |
| **Add** : Decrease in current assets (other than cash and cash equivalent)<br>Increase in current liabilities. | + XXX<br>+ XXX |
| **Less**: Increase in current assets (other than cash and cash equivalent)<br>Decrease in current liabilities | ( - XXX)<br>( - XXX) |
| **Cash Flows from Operation Activities before Tax and Extraordinary items** | **XXX** |
| **Less** – Income tax paid | + XXX |
| **Add/Less** - Effects of Extraordinary Items | +/- XXX |
| **Net Cash from Operating Activities** | **XXX** |

**Note** – Ind AS 7 encourages firm to use direct method. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method.

## Cash flow from investing activities

- Investing activities are transactions related to purchase and sale of long-term assets or fixed assets such as machinery, furniture, land and building, etc.
- These resources intended to generate future income and cash flows.
- Only expenditures that result in a recognized asset in the balance sheet are eligible for classification as investing activities.

**Cash outflow from investing activities**

- ✓ Purchase of fixed assets including intangible
- ✓ Purchase of shares, warrants, debt instruments or securities for investment purpose
- ✓ Advance loan made to third party (other than advances and loans made by a financial enterprise/banks wherein it is operating activities)
- ✓ Cash payments for futures contracts, forward contracts, option contracts and swap contracts (not for trading purpose)

**Cash inflow from investing activities**

- ✓ Sale of fixed assets
- ✓ Sale of shares, warrants, debt instruments or securities for investment purpose
- ✓ Dividend received from shares
- ✓ Cash received from repayment of loan and advances made to third party
- ✓ Interest received from loans and advances
- ✓ Cash receipts from futures contracts, forward contracts, option contracts and swap contracts (not for trading purpose)

# Cash flow from financing activities

Financing activities are transactions related to raising funds for the business and repaying them. It includes activities relate to long-term funds or capital of an enterprise, e.g., cash proceeds from issue of equity shares, debentures, raising long-term bank loans, repayment of bank loan, etc. These **activities result in changes in the size and composition of the contributed equity and borrowings** of the entity. Cash flow from financing activity is useful in predicting claims on future cash flows by providers of capital to the entity.

**Cash inflow from financing activity**

- ✓ Issue of shares, debentures, bonds and other securities
- ✓ Loan taken

**Cash outflow from financing activity**

- ✓ Repayment of amount borrowed
- ✓ Dividend paid on shares
- ✓ Interest paid on debentures/loans
- ✓ Redemption of preference shares
- ✓ Buy back of equity shares

# Other important points to remember

- ➢ Bank borrowings are generally considered to be financing activities. However, where bank overdrafts which are repayable on demand, form an integral part of an entity's cash management, **bank overdrafts are included as a component of cash and cash equivalents.**
- ➢ If the purpose for which the firm paid the **tax** is classified, then put that tax under specific head.

  For example, tax paid on the capital gain on the sale of building is easily identified as investing activity. So, subtract the tax amount from the cash flow from the investing activity.

- Firm may hold **securities and loans for dealing or trading purpose** as in case of financial institutions and banks. It is similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities.
- Cash flows arising from **interest paid and interest and dividends received in the case of a financial institution** should be classified as cash flows arising from operating activities.
- Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows.

**Foreign currency cash flows**

- Cash flows arising from transactions in a foreign currency shall be recorded in a domestic currency by applying exchange rate between the domestic currency and the foreign currency at the date of the cash flow.
- Cash flows denominated in a foreign currency are reported in a manner consistent with Ind AS 21, The Effects of Changes in Foreign Exchange Rates
- The cash flows of a **foreign subsidiary** shall be translated at the exchange rates between the domestic currency and the foreign currency at the dates of the cash flows.
- Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows.

  However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported as disclosure in reconciliation statement.

  For example, a firm has received 1000 dollars from the sale of good on 1st September. And on the date of sale, the exchange rate is 1 dollar = Rs 50, so in firm's quarter financial statements as on 30th September, it will show Rs 50,000 cash in both balance sheet and cash flow statement.

  Further suppose that on 1st November the exchange rate changes to 1 dollar = Rs 70, it will give foreign exchange gain of Rs 20,000 (1000 X Rs 20), which firm we show in P&L A/c and increase cash & cash equivalent in balance sheet to Rs 70,000.

  The problem is that in cash flow statement, the cash & cash equivalent will still be shown at Rs 50,000 as foreign exchange gain not lead to inflow of cash. It is unrealised gain

So, firm has to disclose this difference of cash (between balance sheet and cash flow statement) in reconciliation statement.

**Changes in ownership interests in subsidiaries and other businesses**

- The aggregate cash flows arising from obtaining or losing control of subsidiaries or other businesses shall be presented separately and classified as investing activities.

## Benefits of Cash Flow Statement

Cash flow statement provides the following benefits:

- A cash flow statement when used along with other financial statements provides information that enables users to **evaluate changes in net assets of an enterprise**.
- Cash flow information is useful in assessing the **ability of the enterprise to generate cash** and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different enterprises.
- It also helps in balancing its cash inflow and cash outflow, keeping in response to changing condition.
- It is also helpful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and impact of changing prices.

# IND AS 11: CONSTRUCTION CONTRACTS

## Introduction

- The objective of this contract is to prescribe the accounting treatment of revenue and costs associated with construction contracts.
- The problem with the construction contracts is, the date of starting the contract and the date of completing the contract, usually falls into different accounting period.
- Therefore, the primary issue in accounting for construction contracts is the allocation of contract revenue and contract costs to the accounting periods in which construction work is performed.
- This Standard shall be applied in accounting for construction contracts in the financial statements of Contractors only. Hence, this standard does not give accounting for the financial statements of Contractee.

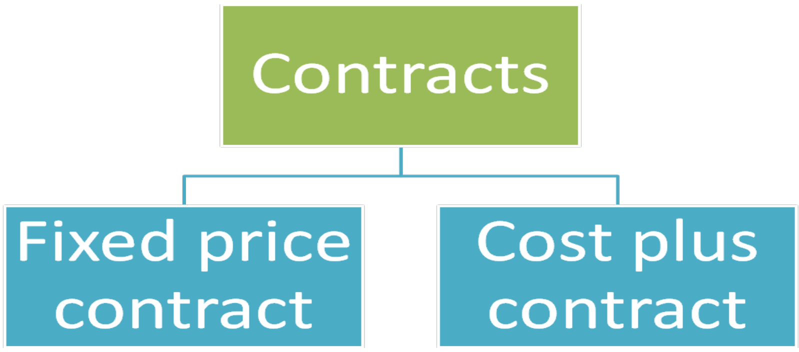
### CONSTRUCTION CONTRACT

A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use. For example, construction of buildings, bridges, dams, etc.

For the purposes of this Standard, construction contracts include:

1) Contracts for the rendering of services which are related to the construction of the asset, for example, those for the services of project managers and architects; and
2) Contracts for the destruction or restoration of assets, and the restoration of the environment following the demolition of assets.

## Types of Contracts




- **Fixed Price Contract -**A fixed price contract is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.

  Subject to cost escalation clause means change in fixed price of contract due change in conditions. For example change in price of raw material.

  **For example**, Infra Constructions receive a contract for construction of a building, the entire cost including profit was decided to received will be Rs 50 lakhs. And there is escalation clause that if cost of material increased by more than 10% then that will be borne by contractee.

  Suppose current cost of bag of cement is Rs 200. If the price of bag increased to Rs 250 then, Rs 20 will be borne by contractor and remaining Rs 30 will be borne by contractee over and above the fixed cost.

- **Cost Plus Contract** - A cost plus contract is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus a percentage of these costs or a fixed fee.

  In contracts, where finding a fixed price of construction is difficult, the contractor can use cost plus profit method, in which contractee pays cost plus profit (as percentage of cost) to contractor.

For example, Infra Constructions receive a contract for construction of a building, and following terms were agreed upon,

The entire cost of the project will be reimbursed to Infra Constructions (estimated cost of the project being Rs 25,00,000)

The profits will be 20% of the entire cost of a project subject to a max of Rs 5, 00,000.

So, infra construction will receive Rs 25 lakhs + 20% of Rs 25 lakhs i.e., total of Rs 30 lakhs

- Some construction contracts may contain characteristics of both a fixed price contract and a cost plus contract, for example in the case of a cost plus contract with an agreed maximum price.

## Combining and Segmenting Construction Contracts

Suppose, there is one single agreement to construct different assets, a contractor should recognise this single agreement as one single contract or should he recognise it as different contracts?

For example- a contract to construct building, park, swimming pool and shop in a single agreement. A contractor should recognise this single agreement as one single contract or should he recognise it as different contracts?

Contractor has to check the following conditions to decide whether to consider the agreement as a single construction contract or separate construction contracts.

**Combining construction contracts**

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

  (a) The group of contracts is negotiated as a single package;

  (b) The contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and

  (c) The contracts are performed concurrently or in a continuous sequence.

**Segmenting construction contracts**

- When a contract covers a number of assets, the construction of each asset shall be **treated as a separate construction contract when**:

  (a) Separate proposals have been submitted for each asset;

  (b) Each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

  (c) The costs and revenues of each asset can be identified.

  For example, a contract for construction of three different buildings on the same plot with different specifications and each building is separately negotiated with the contractor.

- A contract may provide for the construction of an additional asset at the option of the customer or may be amended to include the construction of an additional asset. The construction of the additional asset shall be **treated as a separate construction contract when**:

  (a) The asset differs significantly in design, technology or function from the asset or assets covered by the original contract; **or**

  (b) The price of the asset is negotiated without regard to the original contract price.

## Contract revenue

- Contract revenue is the amount received or receivable from the contract. It shall comprise of:

  (a) The initial amount of revenue agreed in the contract; and

  (b) Variations in contract work, claims and incentive payments:

    i. To the extent that it is probable that they will result in revenue; and

    ii. They are capable of being reliably measured.

- **Variation** – A variation is an instruction by the customer for a change in the scope of the work to be performed under the contract. A variation may lead to an increase or a decrease in contract revenue.

  **For example**, changes in the specifications or design of the asset

  A variation is included in contract revenue when:

  (a) It is probable that the customer will approve the variation and the amount of revenue arising from the variation; and

  (b) The amount of revenue can be reliably measured.

- **Claim** – A claim is an amount that the contractor seeks to collect from the customer or another party as reimbursement for costs not included in the contract price.

  **For example**, customer's delay in decision making, which cause extra rental cost of equipments for contractor

  Claims are included in contract revenue only when:

  (a) Negotiations have reached an advanced stage such that it is probable that the customer will accept the claim; and

  (b) The amount that it is probable will be accepted by the customer can be measured reliably.

- **Incentive payments** –Incentive payments are additional amounts paid to the contractor if specified performance standards are met or exceeded.

  **For example**, a contract may allow for an incentive payment to the contractor for early completion of the contract.

  Incentive payments are included in contract revenue when:

  (a) The contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and

  (b) The amount of the incentive payment can be measured reliably.

- Contract revenue is measured at the fair value of the consideration received or receivable.

- The estimate of revenue will be revised every year when there is change in conditions of contract. The amount of contract revenue may increase or decrease from one year to the next year.

For example:

(a) A contractor and a customer may agree variations or claims that increase or decrease contract revenue in a period subsequent to that in which the contract was initially agreed;

(b) The amount of revenue agreed in a fixed price contract may increase as a result of cost escalation clauses;

(c) The amount of contract revenue may decrease as a result of penalties arising from delays caused by the contractor in the completion of the contract; or

(d) When a fixed price contract involves a fixed price per unit of output, contract revenue increases as the number of units is increased.

## Contract costs

- Contract costs shall comprise:

(a) Costs that relate directly to the specific contract;

(b) Costs that are attributable to contract activity in general and can be allocated to the contract; and

(c) Such other costs as are specifically chargeable to the customer under the terms of the contract.

| **Costs that relate directly to a specific contract** | **Costs that may be attributable to contract activity** |
|---|---|
| ✓ Site labour costs, including site supervision;<br>✓ Costs of materials used in construction;<br>✓ Depreciation of plant and equipment used on | ✓ Insurance;<br>✓ Costs of design and technical assistance that are not directly related to a specific |

| | |
|---|---|
| the contract;<br>✓ Costs of moving plant, equipment and materials to and from the contract site;<br>✓ Costs of hiring plant and equipment;<br>✓ Costs of design and technical assistance that is directly related to the contract;<br>✓ The estimated costs of rectification and guarantee work, including expected warranty costs;<br>✓ Claims from third parties | contract;<br>✓ Construction overheads (costs such as the preparation and processing of construction personnel payroll) |
| These costs may be reduced by any incidental income that is not included in contract revenue, for example income from the sale of surplus materials and the disposal of plant and equipment at the end of the contract. | Such costs are allocated using methods that are systematic and rational and are applied consistently to all costs having similar characteristics. |

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

    (a) General administration costs for which reimbursement is not specified in the contract;

    (b) Selling costs;

    (c) Research and development costs for which reimbursement is not specified in the contract;

    (d) Depreciation of idle plant and equipment that is not used on a particular contract.

- **Costs are incurred in securing the contract** are also included as part of the contract costs if,

    (a) They can be separately identified

    (b) Measured reliably

(c) It is probable that the contract will be obtained.

Costs incurred in securing a contract are recognised as an expense in the period in which they are incurred, they are not included in contract costs when the contract is obtained in a subsequent period.

## Recognition of contract revenue and expenses

- Contract revenue and cost should be recognised with reference to the stage of completion of contract activity at the end of the reporting period and the outcome of the contract can be estimated reliably.
- The outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:

  1. In the case of a fixed price contract,

     (a) Total contract revenue can be measured reliably;

     (b) It is probable that the economic benefits associated with the contract will flow to the entity (i.e., cash flow);

     (c) Both the contract costs to complete the contract and the stage of contract completion at the end of the reporting period can be measured reliably; and

     (d) The contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

  2. In the case of a cost plus contract

     (a) It is probable that the economic benefits associated with the contract will flow to the entity (i.e., cash flow);;

     (b) The contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.

- When the outcome of a construction contract **cannot be estimated** reliably:

(a) Revenue shall be recognised only to the extent of contract costs incurred that it is probable will be recoverable; and

(b) Contract costs shall be recognised as an expense in the period in which they are incurred

## How to Recognize Revenue and Expense

**Percentage Completion Method**

- Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed.
- Under the percentage of completion method,

  (a) Contract revenue is recognised as revenue in profit or loss in the accounting periods in which the work is performed.

  (b) Contract costs are usually recognised as an expense in profit or loss in the accounting periods in which the work to which they relate is performed.

- A contractor may have incurred contract costs that relate to future activity on the contract. Such contract costs are recognised as an asset provided it is probable that they will be recovered. Such costs represent an amount due from the customer and are often classified as contract work in progress.

  For example, if contractor purchase raw material, the part of raw material used is considered as expense and remaining raw material will be shown in balance sheet as asset.

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

  For example, H ltd done construction of worth Rs 10,00,000 to N ltd, amount of which is yet to be received and H ltd has recognised revenue in respect of said transactions. However, after few days N ltd has filed for bankruptcy. Thereby, the collectability of the amount has ceased to be probable. So, H ltd should record the uncollectible amount of Rs 10,00, 000 as an expense. It should not reverse the revenue of Rs 10,00,000 that has already been recognised.

## Determination of the stage of completion

Depending on the nature of the contract, the methods may include

a. The proportion that contract costs incurred for work performed to date bear to the estimated total contract costs

   For example: if the total cost of the contract is Rs. 50 lakhs and the cost incurred till date is Rs. 25 lakhs, the stage of completion is regarded as 50%

b. Surveys of work performed;

   For example: in a contract for construction of a bridge, the site inspector can do a survey and with regards to the technicalities of the project, inform how much work has been completed

c. Completion of a physical proportion of contract work

   For example: in a contract for construction of a 10 km road, if 3 km road is constructed, the stage of completion for the same is regarded as 30%

- Progress payments and advances received from customers often do not reflect the work performed.
- When the stage of completion is determined by reference to the contract costs incurred to date, only those contract costs that reflect work performed are included in costs incurred to date. Examples of contract costs which are excluded are:

  1. Contract costs that relate to future activity on the contract, such as costs of materials that have been delivered to a contract site or set aside for use in a contract but not yet installed, used or applied during contract performance.
  2. Payments made to subcontractors in advance of work performed under the subcontract.

- During the early stages of a contract it is often the case that **the outcome of the contract cannot be estimated reliably**. Nevertheless, it may be probable that the entity will recover the contract costs incurred.
- Therefore, contract revenue is recognised only to the extent of costs incurred that are expected to be recoverable. As the outcome of the contract cannot be estimated reliably, no profit is recognised.
- Contract costs that are not probable of being recovered are recognised as an expense immediately. For example, contractor is unable to complete the contract.

## Recognition of expected losses

- When it is probable that total contract costs will exceed total contract revenue, the expected loss shall be recognised as an expense immediately.
- The amount of such a loss is determined irrespective of:

  (a) Whether work has commenced on the contract;

  (b) The stage of completion of contract activity; or

  (c) The amount of profits expected to arise on other contracts which are not treated as a single construction contract

## Disclosure

- An entity shall disclose:

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

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

  (c) The methods used to determine the stage of completion of contracts in progress.

- An entity shall disclose each of the following for contracts in progress at the end of the reporting period:

  (a) The aggregate amount of costs incurred and recognised profits (less recognised losses) to date;

  (b) The amount of advances received; and

  (c) The amount of retentions.

# IND AS 16: PROPERTY, PLANT AND EQUIPMENT (PPE)

- PPE refers to all tangible items held for use in production, supply, rental and administrative purpose, for more than 12 months.

- Assets out of Scope of Ind As 16

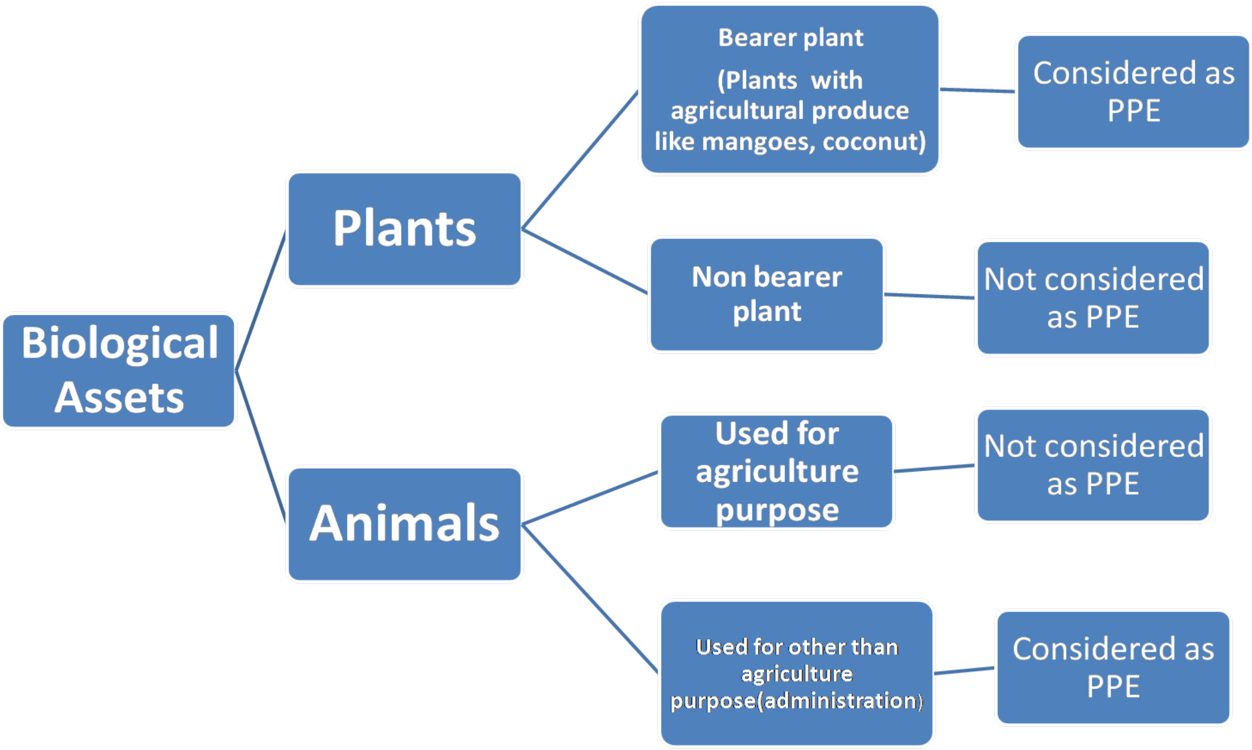
  1) Non-current Assets Held for Sale
  2) Biological assets related to agricultural activity other than bearer plants
  3) Mineral rights and mineral reserves such as oil, natural gas.
  4) Leases

- A bearer plant is a living plant that:

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

  (b) Is expected to bear produce for more than one period; and

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



## When to recognise PPE?

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

  (a) It is probable that **future economic benefits** associated with the item will flow to the entity;

  (b) The cost of the item can be measured reliably

- An entity should evaluate under the recognition principle all its property, plant and equipment costs at the time they are incurred.
- These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it.
- **Elements of cost -** The cost of an item of property, plant and equipment comprises:

  (a) Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

  (b) Any costs directly attributable to bringing the asset to the location. **Example -** Installation and assembly costs, Professional fees, Costs of testing, Initial delivery and handling costs.

  (c) The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.

- **Costs that are not costs of an item of property, plant and equipment are**:

  (a) Costs of opening a new facility.

  (b) Costs of introducing a new product or service (including costs of advertising and promotional activities).

  (c) Costs of conducting business in a new location or with a new class of customer (including costs of staff training).

  (d) Administration and other general overhead costs.

- Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management.

  **For example**, income may be earned through using a building site as a car park until construction starts, the income and related expenses of incidental operations are recognised in profit or loss and included in their respective classifications of income and expense.

- **One or more items of property, plant and equipment may be acquired in exchange for other assets**

  - Cost of such a PPE is measured at fair value.
  - Cost of a PPE is NOT measured at fair value if

    (a) The exchange transaction lacks commercial substance or

    (b) The fair value of neither the asset received nor the asset given up is reliably measurable.

  - An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction.
  - An exchange transaction has commercial substance if:

    (a) The configuration (i.e. risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

    (b) The portion of the entity's operations affected by the transaction changes as a result of the exchange; and

    (c) The difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

  - If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

# Measurement after recognition

- An entity shall choose either the cost model or the revaluation model
- **Cost model** -An item of PPE should be carried at its **cost less any accumulated depreciation** and any accumulated impairment losses.
- **Revaluation model -** An item of PPE should be carried at its **fair value** at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. The frequency of revaluations depends upon the changes in fair values of the items of property, plant and equipment being revalue. Revaluation is to be reviewed for at least once during 3-5 years. But it can be done annually if market is not stable from the point of view of prices.
- **Accounting treatment of revaluation**

**1) First time revaluation** -when first time there is change in fair value and book value (carrying amount) of PPE

**Case 1**- When there is increase in the carrying amount, credit to revaluation surplus.

**Case 2** - When there is decrease in the carrying amount, charge to the statement of profit and loss

**For example, X ltd bought building on 1st August 2019 costing Rs 10 lakhs.**

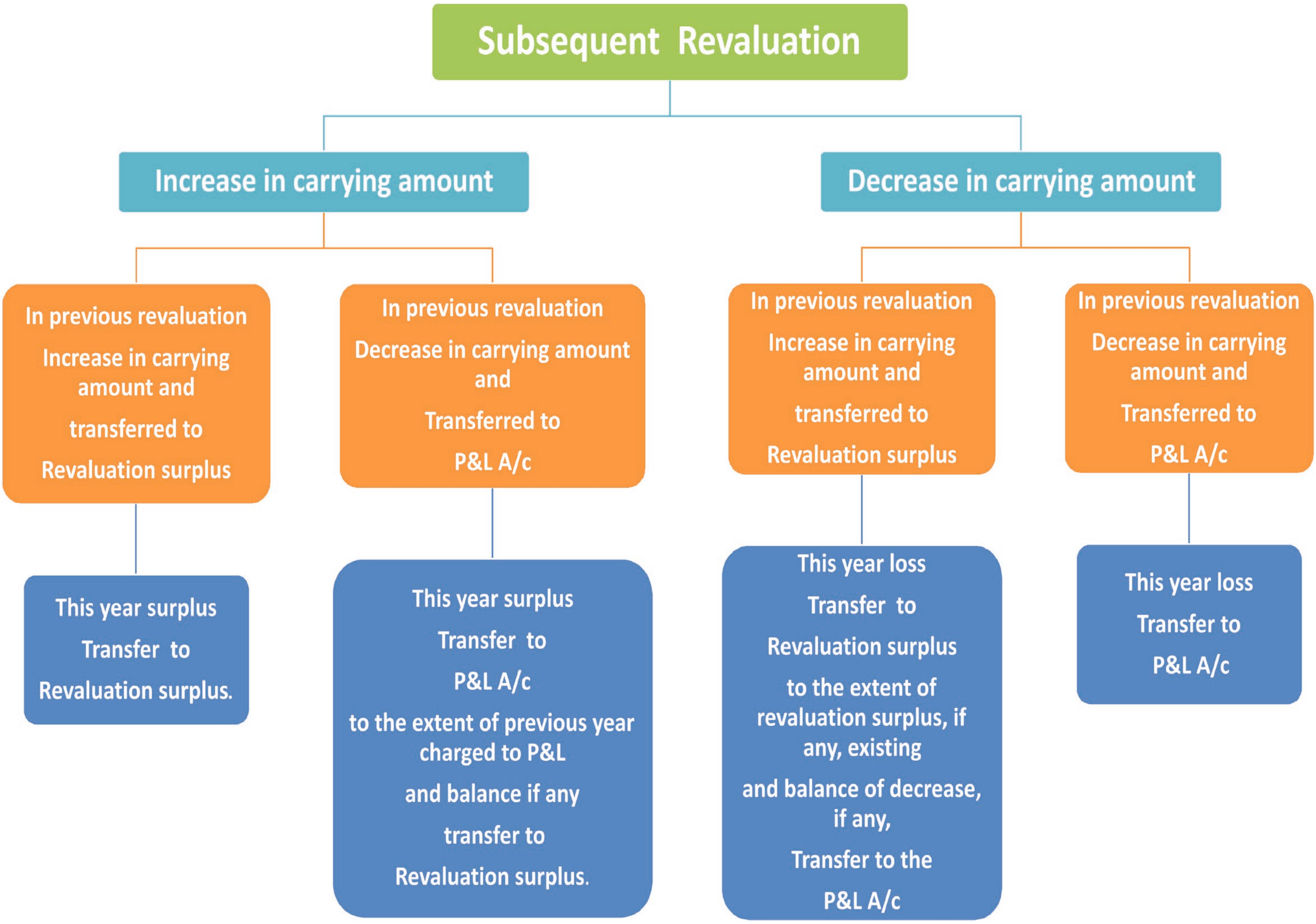
**Case 1 – If at end of year 31st March 2020, the fair value of building is Rs 12 lakhs**. Then X ltd will record building at Rs 12 lakhs in the balance sheet and transfer Rs 2 lakhs to revaluation surplus.

| | | | |
|---|---|---|---|
| Building A/c Dr | | Rs 2 lakhs | |
| | Revaluation surplus A/c | | Rs 2 lakhs |

**Case 2 – If at end of year, the fair value of building is Rs 8 lakhs.** Then X ltd will record building at Rs 8 lakhs in the balance sheet and transfer Rs 2 lakhs to P&L A/c

| | | | |
|---|---|---|---|
| P&L A/c Dr | | Rs 2 lakhs | |
| | Building A/c | | Rs 2 lakhs |

**<u>2) Subsequent revaluation</u>**- when there is already revaluation done on PPE and next year subsequent revaluation required




Continue with example given above,

## <u>Increase in carrying amount</u>

Suppose **fair value of building on 31st March 2021 is Rs 15 lakhs**

- **For case 1 –**

- where in previous revaluation there is increase in carrying amount (Rs 12 lakhs) and profit is transferred to revaluation surplus (Rs 2 lakhs)
- This year, X ltd will record building at Rs 15 lakhs in the balance sheet and transfer Rs 3 lakhs to revaluation surplus.

| | | | |
|---|---|---|---|
| Building A/c | Dr | Rs 3 lakhs | |
| Revaluation surplus A/c | | | Rs 3 lakhs |

➢ **For case 2 –**

- where in previous revaluation there is decrease in carrying amount (Rs 8 lakhs) and loss is transferred to P&L A/c (Rs 2 lakhs)
- This year, X ltd will record building at Rs 15 lakhs in the balance sheet and transfer Rs 2 lakhs to P&L A/c and Rs 5 lakhs to revaluation surplus.

| | | | |
|---|---|---|---|
| Building A/c | Dr | Rs 7 lakhs | |
| P&L A/c | | | Rs 2 lakhs |
| Revaluation surplus A/c | | | Rs 5 lakhs |

## Decrease in carrying amount

Suppose **fair value of building on 31st March 2021 is Rs 6 lakhs**

➢ **For case 1 –**

- where in previous revaluation there is increase in carrying amount (Rs 12 lakhs) and profit is transferred to revaluation surplus (Rs 2 lakhs)
- This year, X ltd will record building at Rs 6 lakhs in the balance sheet and transfer loss of Rs 2 lakhs to revaluation surplus and remaining loss of Rs 4 lakhs to P&L A/c.

| | | | |
|---|---|---|---|
| P&L A/c | Dr | Rs 4 lakhs | |
| Revaluation surplus A/c | Dr | Rs 2 lakhs | |
| Building A/c | | | Rs 6 lakhs |

➢ **For case 2 –**

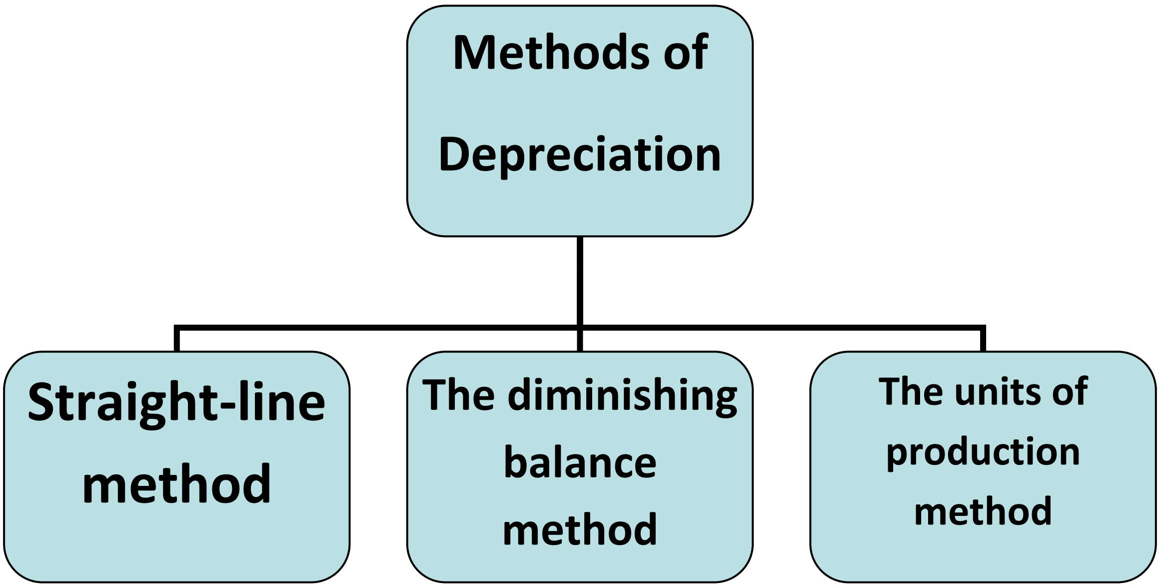
- where in previous revaluation there is decrease in carrying amount (Rs 8 lakhs) and loss is transferred to P&L A/c (Rs 2 lakhs)
- This year, X ltd will record building at Rs 6 lakhs in the balance sheet and transfer loss of Rs 2 lakhs to P&L A/c.

| | | | |
|---|---|---|---|
| P&L A/c | Dr | Rs 2 lakhs | |
| Building A/c | | | Rs 2 lakhs |

➢ The revaluation surplus may be transferred directly to retained earnings when the asset is derecognised/ disposed of.

## Depreciation

➢ Depreciation is an allocation of cost of PPE over its useful life.




➢ **Straight line depreciation** results in a constant charge over the useful life

➢ The **diminishing balance method** results in a decreasing charge over the useful life.

➢ The **units of production method** results in a charge based on the expected use or output.

➢ Depreciation should be calculated for each asset separately. However group of assets can also be formed only if assets are similar.

- If an asset is formed by different components that are having different life then component based depreciation can be charged.
- If land and building are acquired together then depreciation can be charged on building only. Land cannot be depreciated due to unlimited life. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building. In some cases, the land itself may have a limited useful life; in that case it is depreciated in a manner that reflects the benefits to be derived from it.
- The depreciation charge for each period shall be recognised in profit or loss unless it is included in the carrying amount of another asset.
- Depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.
- Depreciation of an asset ceases/stops at the earlier of the date that the asset is classified as held for sale and the date that the asset is derecognised (not used further).
- Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.
- The depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a meaningful change in the expected pattern of consumption of the future economic benefits.

## Impairment

- Impairment is reduction in value of fixed asset of business.

  i.e., Market value of asset < value in balance sheet of company
- **Impairment v/s depreciation**
  - Impairment of an asset emerges when the fair value of an asset unexpectedly goes down below its value while depreciation is the decrease in the value of an asset gradually.
  - Impairment is decrease in the fair market value of Assets due to physical usage, damage, obsolescence, etc as the carrying value exceeds the fair value while

Depreciation is the systematic allocation of the cost of the depreciating assets until the useful life of these assets is expired.

- Impairment account is a loss to the business while depreciation is an expense.

- To determine whether an item of property, plant and equipment is impaired, an entity applies Ind AS 36, Impairment of Assets
- Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up shall be included in profit or loss when the compensation becomes receivable.

## De-recognition

- The carrying amount of an item of property, plant and equipment should be derecognised on disposal and when no future economic benefits are expected from its use or disposal.
- The gain or losses arising from de-recognition of an item of property, plant and equipment should be included in profit or loss when the item is derecognised.
- The gain or loss arising from the de-recognition of an item of property, plant and equipment should be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

## Disclosure

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

- The measurement bases used for determining the gross carrying amount;
- The depreciation methods used;
- The useful lives or the depreciation rates used;
- The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and
- A reconciliation of the carrying amount at the beginning and end of the period showing:

    i. Additions;

ii. Assets classified as held for sale or included in a disposal group classified as held for sale in accordance with Ind AS 105 and other disposals;

iii. Acquisitions through business combinations;

iv. increases or decreases resulting from revaluations and from impairment losses recognised or reversed in other comprehensive income in accordance with Ind AS 36

v. Impairment losses recognised in profit or loss in accordance with Ind AS 36;

vi. Impairment losses reversed in profit or loss in accordance with Ind AS 36;

vii. depreciation;

viii. the net exchange differences arising on the translation of the financial statements from the functional currency into a different presentation currency, including the translation of a foreign operation into the presentation currency of the reporting entity; and

ix. Other changes.

- The financial statements shall also disclose:

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

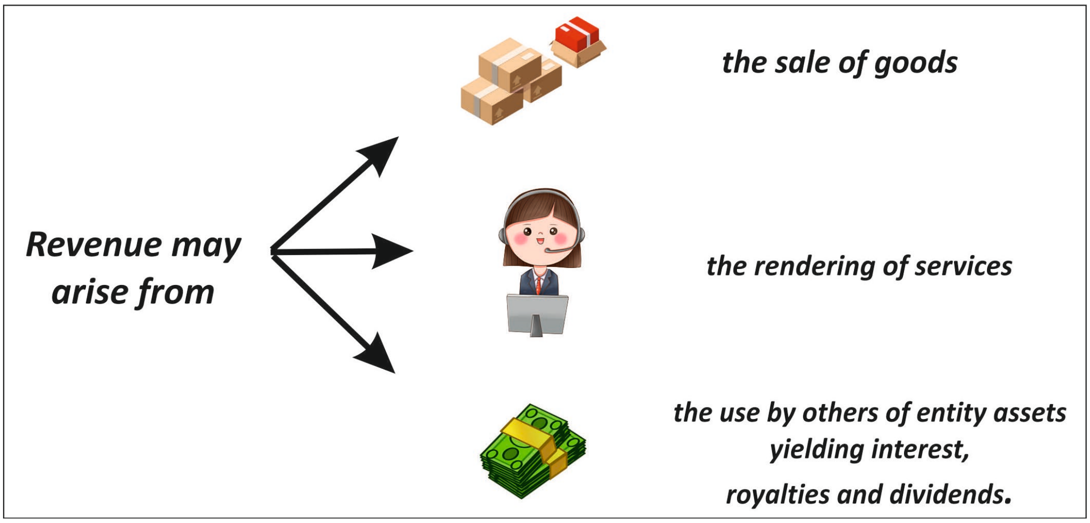
  (b) The amount of expenditures recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;

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

  (d) If it is not disclosed separately in the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss.

# IND AS 18: REVENUE

- Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.




- **Goods** include goods produced by the entity for the purpose of sale and goods purchased for resale, for example merchandise purchased by a retailer or land and other property held for resale.

- The **rendering of services** typically involves the performance by the entity of a contractually agreed task over an agreed period of time. The services may be rendered within a single period or over more than one period.

- The use by others of entity assets gives rise to revenue in the form of:

  (a) **Interest**—charges for the use of cash or cash equivalents or amounts due to the entity;

  (b) **Royalties**—charges for the use of long-term assets of the entity, for example, patents, trademarks, copyrights and computer software; and

  (c) **Dividends**—Dividend is distributions of profits to holders of equity investments in proportion to their holdings of a particular class of capital. Entity may earn dividend from other business firms.

- **When to recognise revenue?**

    1. When it is probable that future economic benefits will flow to the entity and
    2. Benefits can be measured reliably

- **When inflow is not considered as revenue?**

    1. Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes.
    2. Amounts collected on behalf of the principal (agency relationship)(Only commission part will be revenue)

- **This Standard does not deal with revenue arising from**:

    1. Lease agreements (Ind AS 17 Leases)
    2. Dividends arising from investments which are accounted for under the equity method (Ind AS 28 Investments in Associates)
    3. Insurance contracts within the scope of Ind AS 104 Insurance Contracts
    4. Changes in the fair value of financial assets and financial liabilities or their disposal (Ind AS 39 Financial Instruments: Recognition and Measurement)
    5. Changes in the value of other current assets
    6. Initial recognition and from changes in the fair value of biological assets related to agricultural activity ( Ind AS 41 Agriculture)
    7. Initial recognition of agricultural produce (Ind AS 41 )
    8. The extraction of mineral ores.

## Measurement of revenue

- Revenue shall be measured at the **fair value of the consideration** received or receivable.
- **Fair value** is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

- The amount of revenue arising on a transaction is usually determined by agreement between the entity and the buyer or user of the asset.
- It is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the entity.
- The consideration is in the form of cash or cash equivalents.
- **Deferred Revenue** - When the inflow of cash or cash equivalents is deferred, the fair value of the consideration will be calculated by discounting all future receipts using an imputed rate of interest. The fair value of the consideration may be less than the nominal amount of cash received or receivable.

  **For example** – X Ltd is engaged in manufacturing and selling of shoes. It sells shoes on extended credit. X Ltd sold shoes worth Rs 5,00,000 to a wholesaler, the payment against which was receivable after 12 months with interest rate of 3% per annum. The market interest rate on the date of transaction was 8% per annum.

  So X Ltd recognise revenue will be calculated as

  Total amount receivable = Rs 5,00,000 X 1.03 = Rs 5,15,000
  Present value of receivable = Rs 5,15,000 X 0.9259 (from present value table) = Rs 4,76,838.5
  Interest income = Rs 5,15,000 – Rs 4,76,838.5= Rs 38,161.5

  On transaction date Rs 4,76,838.5 will be recognised as revenue from sale of goods and Rs 38,161.5 will be recognised as interest income over the period.

- **When goods or services are exchanged or swapped for goods or services**
  - If goods are of a **similar nature and value**, the exchange is not regarded as a transaction which generates revenue.

    **For example**, X Ltd gave 5000 blue shirts in exchange of 5000 red shirts to another dealer and both the shirts have similar value.
  - When goods are sold or services are rendered in exchange for dissimilar **goods or services**, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at

the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

**For example**, X Ltd got the renovation of one shop carried out by Y ltd in turn; it gave 100 shirts and Rs 5000 to Y ltd as full payment for work. Y ltd would normally charge Rs 15000 for the work done. X ltd usually sells shirts at Rs 100 each. So, X ltd will recognise revenue from sale of goods (shirts) as Rs 10,000 (Rs 15,000 – Rs 5,000)

## Recognition of revenue from sale of goods

**Conditions for recognition of revenue from sale of goods**

(a) Transfer of significant risks and rewards of ownership of the goods (transfer of the legal title or the passing of possession of good to the buyer)

(b) Not continuing managerial involvement to the degree usually associated with ownership and effective control over the goods sold

(c) The amount of revenue can be measured reliably

(d) It is probable that the economic benefits associated with the transaction will flow to the entity

(e) The costs incurred or to be incurred in respect of the transaction can be measured reliably.

- If the entity retains significant risks of ownership, the transaction is not a sale and revenue is not recognised.

Examples of situations in which the entity may retain the significant risks and rewards of ownership are:

(a) When the entity retains an obligation for unsatisfactory performance not covered by normal warranty provisions;

(b) When the receipt of the revenue from a particular sale is contingent on the derivation of revenue by the buyer from its sale of the goods;

(c) When the goods are shipped subject to installation and the installation is a significant part of the contract which has not yet been completed by the entity; and

(d) When the buyer has the right to rescind the purchase for a reason specified in the sales contract and the entity is uncertain about the probability of return

- If an entity retains only an insignificant risk of ownership, the transaction is a sale and revenue is recognised.

  **For example,** an entity retaining only an insignificant risk of ownership may be a retail sale when a refund is offered if the customer is not satisfied. Revenue in such cases is recognised at the time of sale provided, the seller can reliably estimate future returns and recognises a liability for returns based on previous experience and other relevant factors.

- Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity.

- However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectible amount or the amount in respect of which recovery has ceased to be probable is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised.

  **For example**, H ltd export goods worth Rs 1,00,000 to N ltd, amount of which is yet to be received and H ltd has recognised revenue in respect of said transactions. However, after few days N ltd has filed for bankruptcy under overseas legal provision. Thereby, the collectability of the amount has ceased to be probable. So, H ltd should record the uncollectible amount of Rs 1,00,000 as an expense. It should not reverse the revenue of Rs 1,00,000 that has already been recognised.

- Revenue and expenses that relate to the same transaction or other event are recognised simultaneously; this process is commonly referred to as the matching of revenues and expenses.

- Revenue cannot be recognised when the expenses cannot be measured reliably; in such circumstances, any consideration already received for the sale of the goods is recognised as a liability.

## Recognition of revenue from rendering of services

**Conditions for recognition of revenue from rendering of services**

**Case 1:** When the outcome of a transaction involving the rendering of services can be **estimated reliably**

(a) The amount of revenue can be measured reliably

(b) It is probable that the economic benefits associated with the transaction will flow to the entity

(c) The stage of completion (percentage of completion) of the transaction at the end of the reporting period can be measured reliably

(d) The costs incurred for the transaction and the costs to complete the transaction can be measured reliably

- The recognition of revenue by reference to the stage of completion of a transaction is often referred to as the percentage of completion method. Under this method, revenue is recognised in the accounting periods in which the services are rendered.
- The stage of completion of a transaction may be determined by a variety of methods. An entity uses the method that measures reliably the services performed. Depending on the nature of the transaction, the methods may include:

  (a) Surveys of work performed;

  (b) Services performed to date as a percentage of total services to be performed; or

  (c) The proportion that costs incurred to date bear to the estimated total costs of the transaction.

  For example, builder takes contract to construct building. Total cost of the building will be Rs 5 crores and during the year the builder has incurred cost of Rs 3 crores from total Rs 5 crores. So work completed will be Rs 3 crores/ Rs 5 crores =0.6 i.e, 60%

Progress payments and advances received from customers often do not reflect the services performed.

**Case 2**: When the outcome of a transaction involving the rendering of services **cannot be estimated reliably** then revenue shall be recognised only to the extent of the expenses recognised that are recoverable.

When there is no probability of the cost incurred to be recoverable, no revenue is recognized unless it becomes probable.

## Recognition of revenue from Interest, royalties and dividends

Revenue shall be recognised on the following bases:

(a) Interest shall be recognised using the effective interest method as set out in Ind AS 39;

(b) Royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement

(c) Dividends shall be recognised when the shareholder's right to receive payment is established.

## Disclosure

An entity shall disclose:

1. The accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;
2. The amount of each significant category of revenue recognised during the period, including revenue arising from:
    - (a) The sale of goods;
    - (b) The rendering of services;
    - (c) Interest;
    - (d) Royalties;
    - (e) Dividends; and
3. The amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

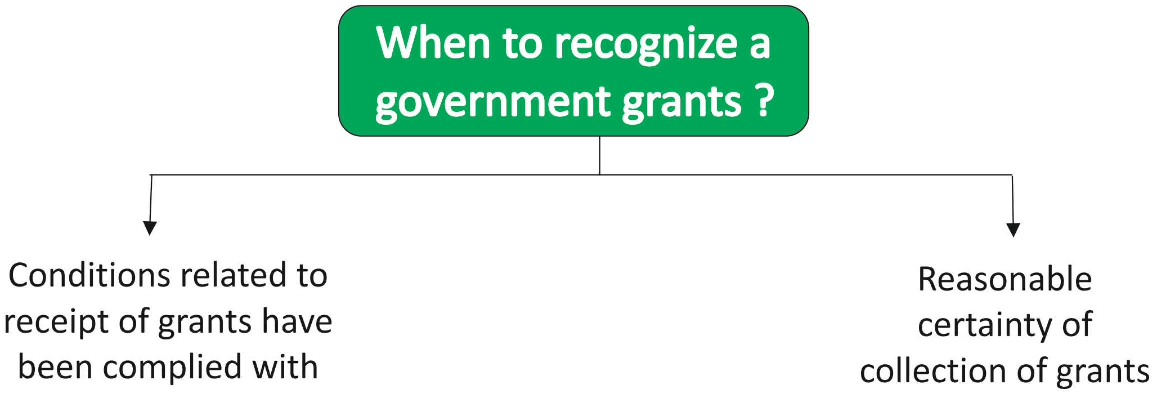
# IND AS: 20 ACCOUNTING FOR GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNMENT ASSISTANCE

- **Scope of the standard** –
    - Ind AS 12 deals with accounting for the government grants such as subsidies, cash incentives, duty drawbacks, etc.
    - It also describe the treatment of non monetary government grants, presentation of grants related to specific fixed assets and revenue, and those in the nature of promoter's contribution (grants to public enterprise) , treatment of refund of government grants
- **Government grants** are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.
- Example, Cash incentives for operating business in Special Economic Zone.
- They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.
- **Government** refers to government, government agencies and similar bodies whether local, national or international.
- **Government assistance** is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria.
- Government assistance for the purpose of this Standard does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

- **Grants related to assets** are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire **long-term assets.** For example, grants from buying assets
- **Grants related to income** are government grants other than those related to assets.
- **Forgivable loans** are loans which the lender undertakes to waive repayment of under certain prescribed conditions.

- **Exclusions**
    2. Forms of government assistance which cannot reasonably have a value placed upon them. Example, free technical or marketing advice.
    3. Transactions with government which cannot be distinguished from the normal trading transactions of the enterprise.

- **Conditions for recognition of government grants**




Government grants should be recognised when there is reasonable assurance that

(i) The enterprise will comply with the conditions attached to them
(ii) The grants will be received

- A government grant is not recognised until there is reasonable assurance that the entity will comply with the conditions attaching to it, and that the grant will be received. Receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

## Accounting treatment for government grants

- Government grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate.

Two broad approaches may be followed for accounting treatment of government grants.

2. **Capital approach** – under this approach, a grant is treated as a part of shareholders funds. Example grants those in the nature of promoter's contribution. As government invest in Government Company.

3. **Income approach** – under this approach, a grant is taken to income over one or more period. Example cash incentives to any private company.

Ind AS 20 allow only income approach of recognition of government grants

- **Grants related to depreciable assets** are usually recognised in profit or loss over the periods and in the proportions in which depreciation expense on those assets is recognised.

- **Grants related to non-depreciable assets** may also require the fulfilment of certain obligations and would then be recognised in profit or loss over the periods that bear the cost of meeting the obligations.

  For example, a grant of land may be conditional upon the erection of a building on the site and it may be appropriate to recognise the grant in profit or loss over the life of the building.

- A **government grant that becomes receivable as compensation for expenses or losses** already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised in profit or loss of the period in which it becomes receivable.

- A government grant may be awarded for the purpose of giving immediate **financial support to an entity** (as in case bailout) rather than as an incentive to undertake specific expenditures. Such grants may be confined to a particular entity and may not be available to a whole class of beneficiaries.

These circumstances may warrant recognising a grant in profit or loss of the period in which the entity qualifies to receive it, with disclosure to ensure that its effect is clearly understood.

- A **government grant may become receivable by an entity as compensation for expenses or losses incurred in a previous period**. Such a grant is recognised in profit or loss of the period in which it becomes receivable, with disclosure to ensure that its effect is clearly understood.
- A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances the fair value of the non-monetary asset is assessed and both grant and asset are accounted for at that fair value.
- **Presentation** –
  1) **Government grants related to assets**, including non-monetary grants at fair value, shall be presented in the balance sheet by setting up the grant as deferred income.
  2) The grant set up as deferred income is recognised in profit or loss on a systematic basis over the useful life of the asset.
  3) **Grants related to income** are sometimes presented as a credit in the statement of profit and loss, either separately or under a general heading such as 'Other income'; alternatively, they are deducted in reporting the related expense.

## Refund of government grants

- If certain conditions which are must to be fulfilled for receiving grants are not met, then grants received from government becomes refundable.
- A government grant that becomes repayable shall be accounted for as a change in accounting estimate (see Ind AS 8)
- Repayment of a grant related to income shall be applied first against any unamortised deferred credit recognised in respect of the grant. To the extent that the repayment exceeds any such deferred credit, or when no deferred credit exists, the repayment shall be recognised immediately in profit or loss.

For example, a firm receive grant of Rs 5 lakhs. It treated grant as a liability and decided to amortise it equally over 5 years. Let suppose after 3 years due to some circumstances that grants of Rs 5 lakhs become refundable. So firm will remove Rs 2 lakh from liability and treat remaining Rs 3 lakhs as loss in P&L A/c

- Repayment of a grant related to an asset shall be recognised by reducing the deferred income balance by the amount repayable
- Government assistance whose value cannot be reasonably measured, such as technical or marketing advice. Only disclosure of the benefits is required.

# Disclosure

The following matters shall be disclosed:

1) the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements;
2) the nature and extent of government grants recognised in the financial statements and an indication of other forms of government assistance from which the entity has directly benefited; and
3) Unfulfilled conditions and other contingencies attaching to government assistance that has been recognised.

# IND AS 21: THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

- The objective of this Standard is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.
- The principal issues are which exchange rate to use and how to report the effects of changes in exchange rates in the financial statements.

## Introduction

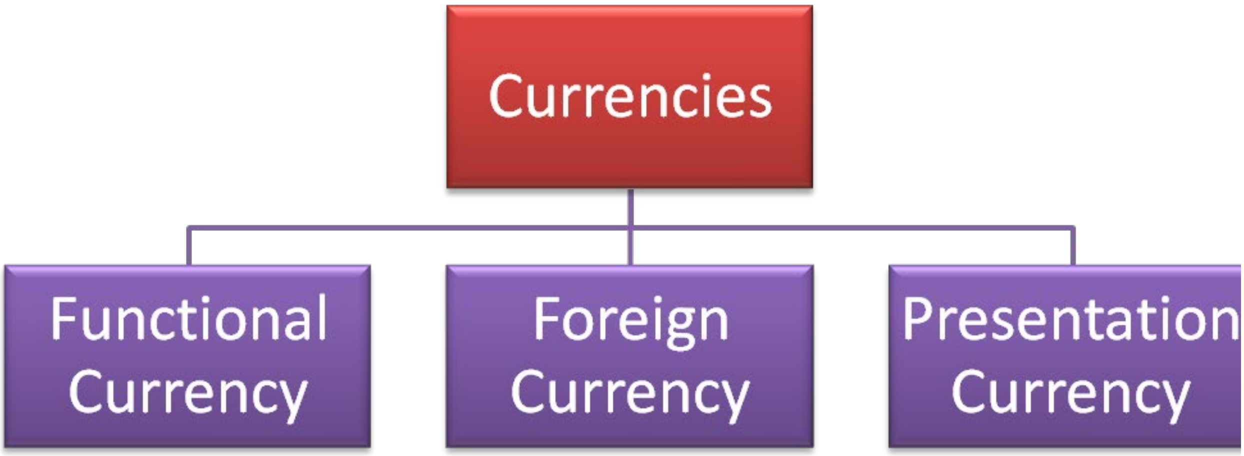
- An entity may carry on **foreign activities** in two ways

  1) It may have **transactions in foreign currency**. **Example,** buying and selling goods in foreign currency

  2) It may have **foreign operation**. **Example,** firm has its subsidiary/ associate/ branch/ joint venture in foreign country.

- **Exchange Rate** is the rate at which foreign currency can be converted into domestic currency (Indian Rupees).
- **Spot exchange rate/ spot rate** is the exchange rate prevails on the date of transaction.
- **Closing rate** is the spot exchange rate at the end of the reporting period (i.e., at end of the financial year)

## Types of currencies




**Functional Currency** is the currency in which business is operated under primary economic environment. It is the currency in which sales, purchases, loans, investments etc. are recorded prominently. Functional currency is currency at which firm's maximum transactions are done. For firm in India, functional currency is **Indian rupees.**

**Foreign Currency** is a currency other than the functional currency of the entity. For firm in India, foreign currency is all other currencies except Indian rupees like **dollars, yen, pound,** etc.

**Presentation Currency** is the currency in which financial statements are prepared. It is also known as reporting currency. For firm in India, presentation currency is Indian rupees. A firm may have more than one presentation currency. Suppose, an Indian company is listed in New York Stock Exchange, then it has to prepare its financial statements in dollars also.

- An entity considers the following **factors in determining its functional currency**:

    1. Currency that influence selling price of goods and services. It means change in regulation of that currency also affect the prices of goods and services of the firm.

2. Currency that mainly influences labour, material and other costs of producing goods and services.

3. Currency in which funds from financing activities are generated (i.e., issuing debt and equity instruments)

4. Currency in which receipts from operating activities are usually retained.

An entity can apply one or more indicators to identify functional currency

- **HOW FOREIGN OPRATION FIRM DETERMINES ITS FUNCTIONAL CURRENCY?**

Whether the functional currency of foreign operation is the same as that of the reporting entity (reporting entity is the entity that has the foreign operation as its subsidiaries, branch, associate or joint venture)

For example, Reliance is an Indian firm and its functional currency is Indian Rupees (Rs.). Reliance has its subsidiary in US called RelMart. Then the US subsidiary of Reliance (RelMart) is foreign operation and the Reliance in India is a reporting entity.

1. **If activities of the foreign operation are carried out as an extension of the reporting entity**. For example, when the foreign operation (RelMart) only sells goods imported from the reporting entity (Reliance) and remits the proceeds to it. Then the functional currency of the reporting entity (Rs.) will be the functional currency of the foreign operation.

2. **If activities of the foreign operation are carried on with a significant degree of autonomy**. For example, when the foreign operation (RelMart) accumulates cash and other monetary items, incurs expenses, generates income and arrange borrowing all substantially in its local currency (US Dollars). Then the functional currency of the reporting entity (Rs.) may not be the functional currency of the foreign operation.

3. **Proportion of transactions**

   - If the proportion of transactions of foreign operation (RelMart) with the reporting entity (Reliance) is **high**. Then the functional currency of the reporting entity (Rs.) will be the functional currency of the foreign operation.

- If the proportion of transactions of foreign operation (RelMart) with the reporting entity (Reliance) is **low**. Then the functional currency of the reporting entity (Rs.) may not be the functional currency of the foreign operation.

4. **If cash flows from the activities of the foreign operation** (RelMart) **directly affect the cash flows of the reporting entity** (Reliance) and are readily available for remittance to it. Then the functional currency of the reporting entity (Rs.) will be the functional currency of the foreign operation.
5. **If the cash flows from the activities of the foreign operation** (RelMart) **are sufficient to serve its debt obligations** without funds being made available to it by the reporting entity (Reliance). Then the functional currency of the reporting entity (Rs.) may not be the functional currency of the foreign operation.

When the above indicators are mixed and the functional currency is not obvious, management uses its judgement to determine the functional currency that most faithfully represents the economic effects of the transactions, events and conditions of the firm.

## Net investment in a foreign operation

- Net investment in a foreign operation is the amount of the reporting entity's interest in the net assets of that foreign operation.
- An entity may have a monetary item that is receivable from or payable to a foreign operation.
- An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation.
- For example, an entity provide loan to its foreign operation, if settlement of the loan is neither planned nor likely to occur in the foreseeable future then such loan is considered as net investment in foreign operation.

# Monetary & Non-Monetary Items

- **Monetary items** are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency. It means the value of money is fixed and determinable.

  **For example**, pension paid in cash, the amount we have to pay is fixed and not going to change. Similarly, accounts receivable, the money we are going to receive in future is fixed.

- **Non monetary items** are items in which there is absence of a right to receive (or an obligation to pay) a fixed or determinable number of units of currency.

  **For example**, inventory, the money we are going to receive by selling inventory in future is not fixed; it may be lower or higher than our expected value. Similarly, land and building, when we are going to sell them in market, we can get higher or lower amount than book value.

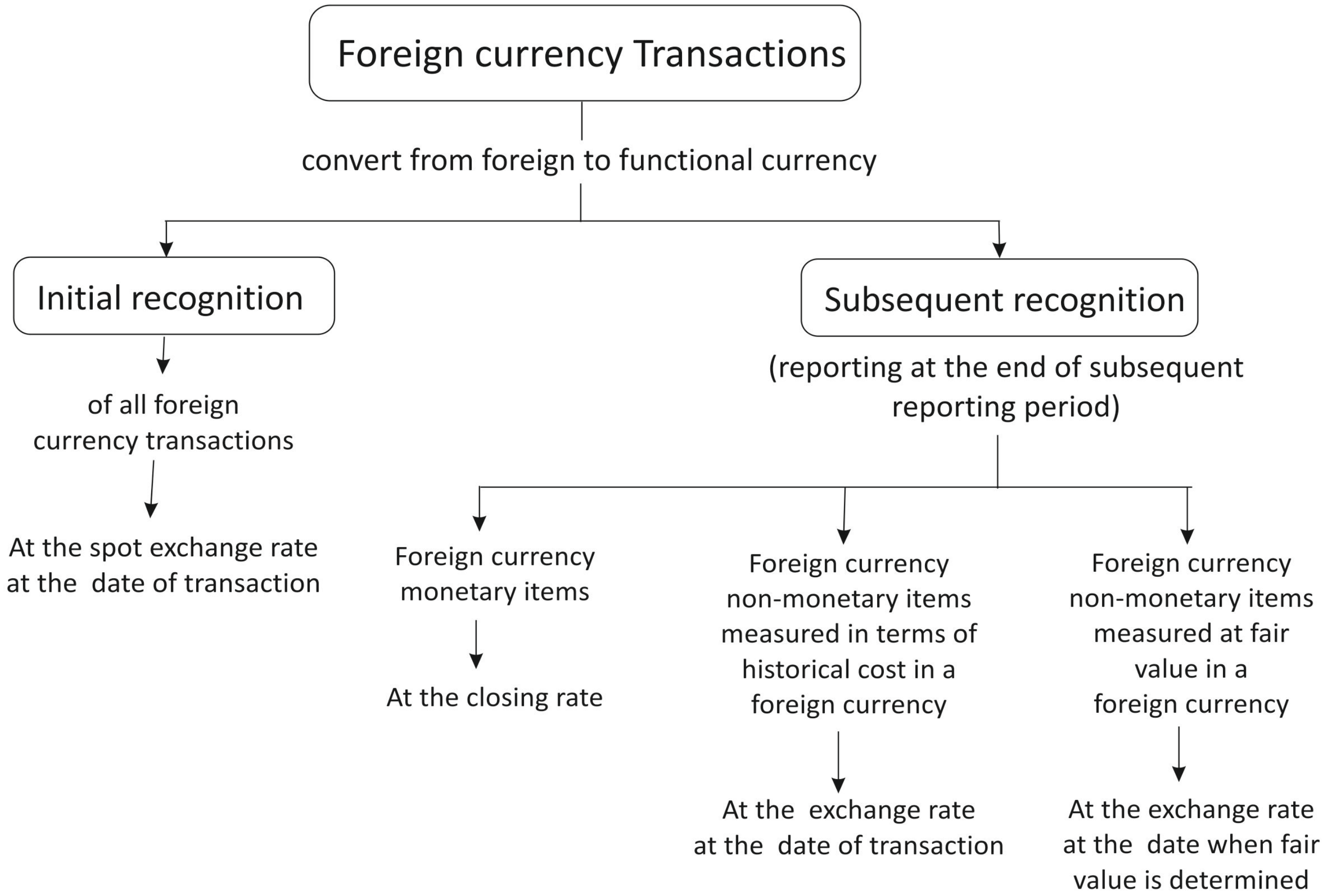
# Accounting for foreign currency transactions

**Foreign currency transaction** is a transaction that is denominated or requires settlement in a foreign currency.

Example,

1. Buys or sells goods or services whose price is denominated in a foreign currency
2. Borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency
3. Acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

**Reporting of foreign currency transaction**




- The carrying amount of an item is determined in conjunction with other relevant Standards.

  Example,

  1. Property, plant and equipment may be measured in terms of fair value or historical cost in accordance with Ind AS 16 Property, Plant and Equipment.
  2. The carrying amount of inventories is the lower of cost and net realisable value in accordance with Ind AS 2 Inventories.
  3. the carrying amount of an asset for which there is an indication of impairment is the lower of its carrying amount before considering possible impairment losses and its recoverable amount in accordance with Ind AS 36 Impairment of Assets

## Recognition of exchange differences

- Exchange differences arising shall be recognised in profit or loss in the period in which they arise.

- **For example**, N ltd import goods on credit worth 5000 dollars on 15th January and the exchange rate on 15th January is 1 Dollar = Rs 50.

  So, as initial recognition on 15th January, N ltd create liability of Rs 2,50,000 (5000 X 50).

  Further suppose that, for the year ending 31st March exchange rate was 1 Dollar = Rs 60. It means that N ltd has to pay more in Indian rupees.

  So, as subsequent recognition on 31st March, N ltd increase liability by Rs 50,000 to Rs 3,00,000 (5000 X 6). And that loss of Rs 50,000 will be transferred to P&L A/c.

- The exception is that exchange differences arising on monetary items that form part of the reporting entity's net investment in a foreign operation are recognised, in the consolidated financial statements that include the foreign operation, in other comprehensive income; they will be recognised in profit or loss on disposal of the net investment

## Translation to the presentation currency from functional currency

If the presentation currency differs from the entity's functional currency, it translates its results and financial position into the presentation currency.

- **For entity whose functional currency is not the currency of a hyperinflationary economy** (hyperinflation economy is country with very high rate of inflation)

  (a) Assets and liabilities for each balance sheet presented (i.e. including comparatives) shall be translated at the closing rate at the date of that balance sheet;

  (b) Income and expenses for each statement of profit and loss presented (i.e. including comparatives) shall be translated at exchange rates at the dates of the transactions

  (c) All resulting exchange differences shall be recognised in other comprehensive income. These exchange differences are not recognised in profit or loss because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations.

- **For entity whose functional currency is the currency of a hyperinflationary economy**

  - All amounts (i.e. assets, liabilities, equity items, income and expenses, including comparatives) shall be translated at the closing rate at the date of the most recent balance sheet.

  - When an entity's functional currency is the currency of a hyperinflationary economy, the entity shall restate its financial statements in accordance with Ind AS 29 before applying the translation method.

## Disposal or partial disposal of a foreign operation

- On the **disposal of a foreign operation**, the cumulative amount of the exchange differences relating to that foreign operation, recognised in other comprehensive income and accumulated in the separate component of equity, shall be reclassified from equity to profit or loss when the gain or loss on disposal is recognised.

- On the **partial disposal** of a subsidiary that includes a foreign operation, the entity shall re-attribute the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income to the non-controlling interests in that foreign operation.

- In any **other partial disposal** of a foreign operation the entity shall reclassify to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income.

# IND AS 33 : EARNING PER SHARE

## Objective and Scope of AS 33

### Objective

EPS may help investors to

1) **Compare performance of two different entities** (i.e., Vodafone v/s Idea)

2) **Compare an entity with itself over a period**. It means we can compare company's current year performance with previous year's performance. (i.e., 2021 v/s 2020)

### Scope

If firm is preparing

1) **Consolidated financial statements** then find **Consolidated EPS** only. It means combined EPS of both parent and subsidiary company if consolidated financial statement is prepared.

2) **Separate financial statements** then find **Separate EPS** only.

## Definitions

- **An equity instrument** –A contract that act as evidence of ownership rights.
- **An ordinary share** is an equity instrument that is subordinate to all other classes of equity instruments.
- **A potential ordinary share** is a financial instrument or other contract that may entitle its holder to ordinary shares in future. It means instruments which might be converted into equity shares in future.

Example – 1) Convertible preference shares
2) Options and Warrants
3) Shares that would be issued upon the satisfaction of conditions resulting from contractual arrangements, such as the purchase of a business or other assets.

- **Options and Warrants** - are financial instruments that give the holder the right to purchase ordinary shares. It means that the option holder has option to buy the shares of the company on the specified date at a specific price.

- **Earnings per share**

$$EPS = \frac{\text{net income} - \text{dividend payments}}{\text{weighted average shares outstanding}}$$

- **Dilution** is a reduction in earnings per share or an increase in loss per share, resulting from assumption that
  1) Convertible instruments are converted,
  2) Options or warrants are exercised,
  3) Ordinary shares are issued upon the satisfaction of specified conditions.

  It means decrease in EPS due to increase in average number of shares in denominator.

- **Anti-dilution** is an increase in earnings per share or a reduction in loss per share. It is opposite of dilution.

- **TYPES OF EPS**

  1) Basic EPS

  2) Diluted EPS

## Basic EPS

$$\text{Basic EPS} = \frac{\text{profit or loss attributable to ordinary equity holders of the parent entity}}{\text{the weighted average number of ordinary shares outstanding}}$$

- **Earnings available for distribution to equity shareholders** is equal to net profit/loss of the firm less adjustments related to preference share capital (Preference dividend and tax on preference dividend)

| Earnings available for equity shareholder = Net profits – preference dividend |
|---|

- Adjustment related to preference dividend

| Cumulative Pref. Share Capital | Non-Cumulative Pref. Share Capital |
|---|---|
| Consider dividend on accrual basis whether it is declared or not by the entity. Deduct amount from the current year. | Consider it only if it is declared in current year & paid in current year |

- **Weighted Average Number of Shares (WANS) –**

WANS = No. of Shares outstanding during the Period x Time factor (Period of outstanding)

Example: Question -

Opening Balance (1.4.2020) = 10,000 shares

New Issue (1.7.2020) = 20,000 Shares

Calculate WANS for the Period

Answer –

Opening Balance (1/4/2020 – 31/3/2021) = 10,000 x 12/12 = 10,000 shares

New issue (1/7/2020 – 31/3/2021) = 20,000 x 09/12 = 15,000 Shares

**WANS = 25,000 shares**

| List of shares issued | Weight to be considered/adjusted from |
|---|---|
| Ordinary shares issued in exchange for cash | Date when cash is receivable |
| Ordinary shares issued in exchange for the settlement of a liability of the entity | Date of settlement of liability |
| Ordinary shares issued as consideration for the acquisition of assets other than cash | Date on which the acquisition of asset is recognised |

| | |
|---|---|
| Ordinary shares issued for rendering services to the entity | Date when service is rendered |
| Ordinary shares issued for interest or principal on any financial instrument | Date on which interest ceases to accrue |
| Ordinary shares issued in business combination | Date of acquisition |

- If an entity **buys back** its equity shares then WANS should be reduced from the date of such buy back.
- If **Bonus Shares** have been issued by the company during the year then it has two impacts. Along with change in current EPS, we have to change our previous year EPS also.

  1**) Impact on current year EPS**: - we will ignore date of bonus issue while computing WANS. We will add bonus shares directly to WANS without considering any time factor because there will be no change in resources after bonus issue.

  2**) Impact on Previous year' EPS**: - The main objective of changing previous year EPS is to make comparison between the operating results of two financial years. So, previous year' EPS should be re-stated by assuming bonus issue in previous year without considering time factor.

- **Share Split or Share Consolidation/ Reverse Share Split**

- **Share split** means the conversion of existing ordinary shares of higher nominal value into the higher number of ordinary shares of lower nominal value. **For example**, 1 share of Rs 50 may be converted into 5 shares of Rs 10 each.
- **Reverse share split** means the conversion of existing ordinary shares of smaller nominal value into the smaller number of ordinary shares of higher nominal value. For example, 10 share of Rs 50 each may be converted into 1 shares of Rs 500.

  It may be possible that company has followed share split or share consolidation during the year. The following steps should be applied in this case:-

  1. We will ignore date of split/ reverse split while computing WANS. We will assume that company has changed denomination per share in the beginning of year.

2. The entity will also restate EPS for previous year by changing number of shares in denominator assuming such split/reverse split has taken place in previous year for comparison purpose of EPS.

- **Right Issue**

The price at which the right shares are offered to existing shareholders in a company is called **exercise price**. The exercise price is often less than the current market price of the ordinary shares.

The price at which the ordinary shares are traded when the purchase of ordinary shares includes a right to apply for additional shares is called **cum right price.** The price at which the shares are traded when the right issue closes for subscription is called the **ex-right price.**

**Steps to find EPS**

**Step I**: calculate theoretical ex-right price after right issue by the following formula

Theoretical ex-right price =

$$\frac{[\text{No. of shares prior to right issue X cum right price per share}] + [\text{No. of right shares X Right issue price per share}]}{\text{No. of ordinary shares prior to right issue + no. of right shares}}$$

**Step II**: Calculate Right Adjustment Factor (RA factor)

The cum-right price is more than the ex right price. The difference between these two prices is called bonus element or value of the right. Thus, IND AS 33 requires that the number of ordinary shares outstanding before right issue should be multiplies by the following adjustment factor.

Adjustment factor = Cum right price/Theoretical ex right price*

* Calculated in step 1

**Step III**: Computation of WANS for current year

= [No. of shares pre right X right factor X time weight] + [No. of shares post right X time weight]

**Step IV**: Computation of WANS for previous year

= No. of outstanding shares in previous year X right factor

# Diluted EPS

- Diluted EPS means **reduction in Basic EPS** due to Potential Equity Shares.
- If Basic EPS gets increased after considering potential shares then it will be considered as "Anti-dilutive" EPS and it will not be reported.

Diluted EPS =

$$\frac{\text{profit/loss attributable to ordinary equity holders (adjusted for effect of diluted potential equity shares)}}{\text{weighted average number of ordinary shares outstanding (adjusted for effect of diluted potential equity shares)}}$$

- **Convertible Instruments**

| Mandatory conversion | Optional Conversion |
|---|---|
| As per the Provisions of Ind AS 33, Mandatory convertible Bonds/ Shares shall be considered in WANS while computing Basic EPS. These securities do not link with Diluted EPS. It will be assumed that number of Shares promised on conversion have been issued on the date of entering the contract. | As per the provisions of Ind AS 33, Optional conversion shall be considered while computing Diluted EPS because It's an outstanding promise by company for future Issue of Shares. |

- While calculations of profit/loss attributable take finance cost on liability component subject to income tax as saving assuming there is no liability component.
- While calculating WANS add shares subject to conversion.

**Computation of profit/loss attributable to the equity shareholders (after adjustment for the effect of all dilutive potential ordinary shares)**

Compute profit/loss attributable to the equity shareholders

Add – dividend and dividend tax on convertible preference shares

Add –interest (net of tax) charged on convertible debentures or loans

Add/subtract – any other change in income/expense that would result from the conversion of dilutive potential ordinary shares

Question – Study the data given below

| | |
|---|---|
| Net profit for the year ending 31/12/2017 after preference dividend and tax | Rs 1,00,000 |
| Number of equity shares as on 1/1/2017 | 50,000 |
| Number of 12% convertible debentures of Rs 100 each | 1,00,000 |
| The tax rate applicable to the company | 30% |

Each debenture is convertible into 10 equity shares.

Calculate diluted earnings per share.

Solution -

Diluted EPS =

$$\frac{\text{profit/loss attributable to ordinary equity holders (adjusted for effect of diluted potential equity shares)}}{\text{weighted average number of ordinary shares outstanding (adjusted for effect of diluted potential equity shares)}}$$

Profit/loss attributable to the equity shareholders (after adjustment for the effect of all dilutive potential ordinary shares) =

= Net profit + Interest on debenture – Tax savings
= Rs 1,00,000 + ( 12% of Rs 100 X 1,00,000 shares) – (interest X 30%)
= Rs 1,00,000 + Rs 12,00,000 – (Rs 12,00,000 X 30%)
= Rs 9,40,000

Weighted Average Number of Shares (WANS) (after adjustment for the effect of all dilutive potential ordinary shares) =

= existing shares + potential shares
= 50,000 + (10 X 1,00,000 debentures)
= 10,50,000 shares

Dilutes EPS = Rs 9,40,000 / 10,50,000 shares
= Rs 0.895

# IND AS 37: PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

## Introduction

- A **provision** is a liability of uncertain timing or amount.

  For example, provision for doubtful debts, there is uncertainty of amount by how much the debtors will default in future.

- A **liability** is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

  For example, if we buy goods on credit, then we record the creditor as liability. In the given example, past event is buying goods and cash payment in future will be outflow of resources.

- An **obligating event** is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

- A **legal obligation** is an obligation that derives from:

  (a) A contract (through its explicit or implicit terms)

  (b) Legislation

  (c) Other operation of law.

- A **constructive obligation** is an obligation that derives from an entity's actions where:

  (a) By an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities

  (b) As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

For example, a retail store that has a long standing policy of allowing customers to return goods within, say, a 30-day period. There is no legal obligation to allow customers to return goods, but as store is allowing customers to return goods for goodwill from long time, it becomes constructive obligation to replace goods.

- A **contingent liability is**:

  (d) A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

  For example in a lawsuit, the result is out of control of business and there is chance of winning or losing both.

  (e) A present obligation that arises from past events but is not recognised because:

  1. It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
  2. The amount of the obligation cannot be measured with sufficient reliability.

  For example in a lawsuit, amount of punishment is uncertain and cannot be measured; the firm record the event as contingent liability.

- **A contingent asset** is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

- An **onerous contract** is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

  For example, X ltd done a contract to take land on lease for 10 years with annual rental payment. Contract will not be revocable. Let suppose after 6 years that land is of no use for X ltd which means it is not going to give future economic befits to X ltd. But as per contract X ltd has to pay annual rent, despite no use of land. So, this contact becomes onerous contract for X ltd.

## Recognition of Provisions

A provision shall be recognised when:

(a) An entity has a **present obligation** (legal or constructive) 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 shall be recognised.

- In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a lawsuit, it may be disputed either whether certain events result in a present obligation. In such a case, an entity determines whether a present obligation exists at the end of the reporting period by taking account of all available evidence, for example, the opinion of experts.

  a. If it is more likely that obligation exists at the end of the reporting period, the entity recognise it as a provision

  b. If it is more likely that no present obligation exists at the end of the reporting period, the entity discloses a contingent liability

  **For example**, customer file lawsuit against firm, there is both chance of winning or losing the case, if lose then firm has to pay compensation to customer.

  In this case the firm will ask its lawyer that what will be the probability of losing the case.

  If there is higher probability of losing the case, then firm create provision

  If there is lower probability of losing the case, then firm disclose it as a contingent liability

- It is obligations arising from past events are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources regardless of the future actions of the entity.

- An event that does not give rise to an obligation right now but may create obligation in future (because of changes in the law) gives rise to a constructive obligation.

  For example, when environmental damage is caused there may be no obligation right now but when a new law requires the existing damage to be rectified or when the entity publicly accepts responsibility for rectification in a way that creates a constructive obligation.

## Measurement of provision

### Best estimate

- The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

- The estimates of outcome and financial effect are determined by the judgement of the management of the entity, supplemented by experience of similar transactions and, in some cases, reports from independent experts (like lawyers).

- Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities.

  **For example** - An entity sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects that become apparent within the first six months after purchase. If minor defects were detected in all products sold, repair costs of Rs 1 million would result. If major defects were detected in all products sold, repair costs of Rs 4 million would result. The entity's past experience and future expectations indicate that, for the coming year, 75 per cent of the goods sold will have no defects, 20 per cent of the goods sold will have minor defects and 5 per cent of the goods sold will have major defects.

  In accordance with this, an entity assesses the probability of an outflow for the warranty obligations as a whole. The expected value of the cost of repairs is:

  (75% of nil) + (20% of 1m) + (5% of 4m) = Rs 400,000

- Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the entity considers other possible outcomes.

  For example, if an entity has to rectify a serious fault in a major plant that it has constructed for a customer, the individual most likely outcome may be for the repair to succeed at the first attempt at a cost of Rs 1,000, but a provision for a larger amount is made if there is a significant chance that further attempts will be necessary.

➢ The provision is measured before tax, as the tax consequences of the provision, and changes in it, are dealt with under Ind AS 12.

## Risks and uncertainties

The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision.

For example, if we found that there is higher risk then we can add that risk amount in past provision.

## Present value

Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.

For example, if we have to make a provision for a liability which is to be paid after 3 years, then we don’t take actual amount. We will make a provision by discounting the amount.

The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability.

## Future events

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

For example, an entity 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 entity can reduce its provision.

## Expected disposal of assets

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

## Reimbursements

Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement shall be treated as a separate asset. The amount recognised for the reimbursement shall not exceed the amount of the provision.

## Changes in provisions

Provisions shall be reviewed at the end of each reporting period 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 shall be reversed.

## Use of provisions

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

## Future operating losses

Provisions shall not be recognised for future operating losses.

An expectation of future operating losses is an indication that certain assets of the operation may be impaired. An entity tests these assets for impairment under Ind AS 36, Impairment of Assets.

### Onerous contracts

If an entity has a contract that is onerous, the present obligation under the contract shall be recognised and measured as a provision.

## Restructuring

- Restructuring is change in business structure. For example,

  (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;

  (d) Fundamental reorganisations that have a material effect on the nature and focus of the entity's operations.

- A company can make provision for restructuring costs only when the general recognition criteria for provisions are met.
- A constructive obligation to restructure arises only when an entity:

  (a) Has a detailed formal plan for the restructuring

  (b) Has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

- For example, a company has informed its employees, customers and suppliers about termination of a line of business.
- No obligation arises for the sale of an operation until the entity is committed to the sale, i.e. there is a binding sale agreement.
- A restructuring provision shall 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 entity.

➢ 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 end of the reporting period. Such expenditures are recognised on the same basis as if they arose independently of a restructuring.

# IND AS 38: INTANGIBLE ASSETS

## Meaning of intangible asset

Intangible Asset is as an identifiable non-monetary asset without physical substance.

For an item to be recognised as an intangible asset, it must meet all the following six conditions:

**Condition 1: It should be an identifiable asset which is separate from others.**

- An asset is identifiable if it either:

3) **Separable**, i.e., is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged.

   For example,

   (a) A company has bought a software, which if they don't want to use in future then company can sell or rent that software to some other entity , then that software is considered as intangible asset.

   (b) Suppose a company has bought a laptop which comes with inbuilt software, which is inseparable and not useful without that laptop. Then that software is not considered as intangible asset because company can't sell or transfer that software only.

4) **Arises from contractual or other legal rights,** regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

   For example, X ltd done contract with pizza hut to buy franchise for setting up store in Delhi. Then that franchise amount will be intangible asset.

**Condition 2: It should be a non-monetary asset.**

The assets are classified into two categories

1. **Monetary assets** – A monetary asset is an asset whose value is stated in or convertible into a fixed amount of cash. It means the value of asset is fixed and determinable. For example, accounts receivable/debtors, the money we are going to receive in future is fixed.

2. **Non-Monetary assets** – A non monetary asset is an asset whose value is NOT stated in or convertible into a fixed amount of cash. For example, inventory, the money we are going to receive by selling inventory in future is not fixed; it may be lower or higher than our expected value. Similarly, land and building, when we are going to sell them in market, we can get higher or lower amount than book value. The value of non monetary assets change frequently.

Intangible asset should be of non monetary nature.

## Condition 3: It should be without physical substance

It should not be a Tangible Asset.

## Condition 4: It will give future economic benefits

The future economic benefits flowing from an intangible asset may include

1. Revenue from the sale of products or services,
2. Cost savings, or
3. Other benefits resulting from the use of the asset by the entity. E.g. Tax benefits

For example, the use of intellectual property in a production process may reduce future production costs rather than increase future revenues.

## Condition 5: It should be under the control of the enterprise

- An entity controls an asset if the entity has the power
    1. To obtain the future economic benefits flowing from the underlying resource. It means the revenue generated from that intangible asset will be received by firm only.

2. To restrict the access of others to those benefits. It means that the enterprise can restrict/stop others from taking benefits from controlled assets.

- The capacity of an entity to control the future economic benefits from an intangible asset would normally come from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control.

**Condition 6: It should be held for use**

It should not be held for sale in ordinary course of business.

For example, firm has a business of selling software, then it will not be covered under intangible assets.

- If any condition out of above specified condition is not satisfied then such an asset will be transferred to P&L A/c as an expense in the same year. It means that all the conditions are required to be satisfied to recognise an asset in business as an intangible asset.
- The following assets can be considered as intangible assets generally : -

  i. Patents  ii. Copy rights  iii. Trademarks

  iv. Scientific Knowledge  v. Technical know how  vi. Franchise agreement

  vii. Computer software etc.

## Intangible Assets which are out of Scope of Ind AS 38

1. Intangible assets held for sale in ordinary course of business (Ind As 2, Inventories)
2. Deferred Tax Assets (Ind AS 12, Income tax)
3. Lease Contracts (Ind AS 17, Leases)
4. Employees Benefits (Ind AS -19, Employee benefits)
5. Financial assets as defined in Ind AS 32.

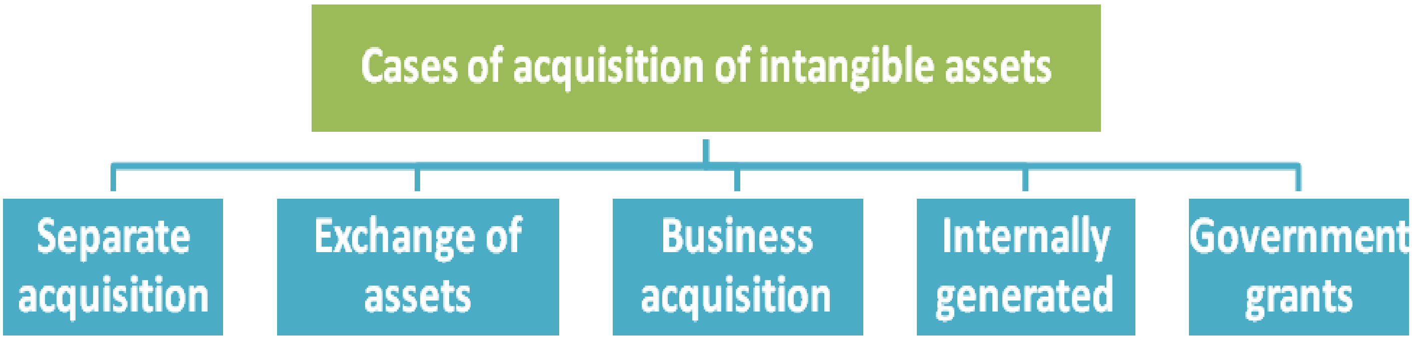
6. Goodwill (Ind 103, Business Combination)
7. Non-current Assets held for Sale (Ind AS 105, Non-current assets held for sale)
8. Assets arising from contracts with customers that are recognised in accordance with Ind AS 115, Revenue from Contracts with Customers
9. Mineral oils, Ores

## Recognition of intangible asset

- Recognition of intangible asset means when the intangible asset will be recorded in books of accounts.
- An intangible asset shall be recognised if, and only if:
    - (c) It is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
    - (d) The cost of the asset can be measured reliably.

## Initial recognition

(Value at which the intangible assets are recorded first time in books of accounts)



## SEPARATE ACQUISITION

- Separate acquisition means intangible asset is purchased by cash.
- An intangible asset shall be measured initially at cost.
- The cost of a separately acquired intangible asset comprises:

  (a) Its **purchase price**, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and

  (b) Any **directly attributable cost** of preparing the asset for its intended use.

- Examples of directly attributable costs are:

  (a) Costs of employee benefits (as defined in Ind AS 19) arising directly from bringing the asset to its working condition;

  (b) Professional fees arising directly from bringing the asset to its working condition;

  (c) Costs of testing whether the asset is functioning properly.

- Examples of expenditures that are **not part of the cost of an intangible asset** are:

  (b) Costs of introducing a new product or service (including costs of advertising and promotional activities);

  (c) Costs of conducting business in a new location or with a new class of customer (including costs of staff training); and

  (d) Administration and other general overhead costs.

  (e) Costs incurred while an asset capable of operating in the manner intended by management has yet to be brought into use

  (f) Initial operating losses, such as those incurred while demand for the asset's output builds up.

  (g) Interest cost on acquisition of intangible assets will not be considered as a cost.

## EXCHANGE OF ASSETS

- Intangible assets may be acquired in exchange of other asset.
- Cost of such an intangible asset is measured at fair value.
- Cost of an intangible asset is NOT measured at fair value if

  (a) The exchange transaction lacks commercial substance or

  (b) The fair value of neither the asset received nor the asset given up is reliably measurable.

- An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction.
- An exchange transaction has commercial substance if:

  (a) The configuration (i.e. risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

  (b) The portion of the entity's operations affected by the transaction changes as a result of the exchange; and

  (c) The difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

➢ If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

## INTERNALLY GENERATED

Internally generated intangible assets can be classified into two headings as follows:-

1. Self generated
2. In house research & development

## Case 1 - Self -generated

- If any intangible assets are generated automatically without incurring any expenditure then it is known as self- generated assets. These intangible assets are generated by conditions and efforts of business for customer satisfaction. These may be in the form of :
  - goodwill
  - brand name
  - customer list
  - Publication titles etc.
- Treatment: These assets are not recognised in business, because these items are free of cost.
- Internally generated goodwill is not recognised as an asset because it is not an identifiable resource (i.e. it is not separable nor does it arise from contractual or other legal rights) controlled by the entity that can be measured reliably at cost.

## Case 2 -In house research & development

### (A) Research phase –

- No intangible asset arising from research (or from the research phase of an internal project) shall be recognised in business. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred.
- In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Therefore, this expenditure is 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; and

(d) The formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

**(B) Development phase -**

- An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:

    1. The technical feasibility of completing the intangible asset so that it will be available for use or sale.
    2. Its intention to complete the intangible asset and use or sell it.
    3. Its ability to use or sell the intangible asset.
    4. How the intangible asset will generate probable future economic benefits. Among other things, the entity can 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.
    5. The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.
    6. Its ability to measure reliably the expenditure attributable to the intangible asset during its development.

- 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 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.

- 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.

- **If all above condition are met then firm can recognise intangible asset at cost of an internally generated intangible asset -** The enterprise should capitalise all the expenses which are incurred during development phase

- The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management.

  Examples of directly attributable costs are:

  (a) Costs of materials and services used or consumed in generating the intangible asset;

  (b) Costs of employee benefits (as defined in Ind AS 19) arising from the generation of the intangible asset;

  (c) Fees to register a legal right; and

  (d) Amortisation of patents and licences that are used to generate the intangible asset.

- 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 preparing the asset for use;

  (b) Identified inefficiencies and initial operating losses incurred before the asset achieves planned performance; and

  (c) Expenditure on training staff to operate the asset.

## BUSINESS ACQUISITION

- Intangible asset may be acquired along with other assets when our business (acquirer) buys some other business firm (acquiree).

- If an intangible asset is acquired in a business combination, the cost of that intangible asset is measured at fair value at the acquisition date.

- The fair value of an intangible asset will reflect market participants' expectations at the acquisition date about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow.
- In accordance with this Standard and Ind AS 103, an acquirer recognises at the acquisition date, an intangible asset of the acquiree, irrespective of whether the asset had been recognised by the acquiree before the business combination.
- An intangible asset acquired in a business combination might be separable, but only together with a related contract, identifiable asset or liability. In such cases, the acquirer recognises the intangible asset separately from goodwill, but together with the related item.
- The acquirer may recognise a group of complementary intangible assets as a single asset provided the individual assets have similar useful lives.
- Subsequent expenditure on an acquired in-process research and development project

  Research or development expenditure that:

  (a) Relates to an in-process research or development project acquired separately or in a business combination and recognised as an intangible asset; and

  (b) Is incurred after the acquisition of that project

  Shall be accounted for in accordance with research and development conditions given above

## GOVERNMENT GRANTS

- In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a Government grant.

- This may happen when a Government transfers or allocates to an entity 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.
- In accordance with Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, an entity may choose to recognise both the intangible asset and the grant initially at fair value.
- If an entity chooses not to recognise the asset initially at fair value, the entity recognises the asset initially at a nominal amount plus any expenditure that is directly attributable to preparing the asset for its intended use

❖ Expenditure on an intangible item that was initially recognised as an expense shall not be recognised as part of the cost of an intangible asset at a later date.

## Measurement after recognition/ subsequent recognition

- ➢ An entity shall choose either the cost model or the revaluation model
- ➢ **Cost model** -An item of intangible asset should be carried at its **cost less any accumulated amortisation** and any accumulated impairment losses.
- ➢ **Revaluation model -** An item of intangible asset should be carried at its **fair value** at the date of the revaluation less any subsequent accumulated amortisation and subsequent accumulated impairment losses. For the purpose of revaluations under this Standard, fair value shall be measured by reference to an active market.

  If an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market for this asset, the asset shall be carried at its cost less any accumulated amortisation and impairment losses.

  Revaluations shall be made with such regularity that at the end of the reporting period the carrying amount of the asset does not differ materially from its fair value.

- **Accounting treatment of revaluation**

**1)** **First time revaluation**

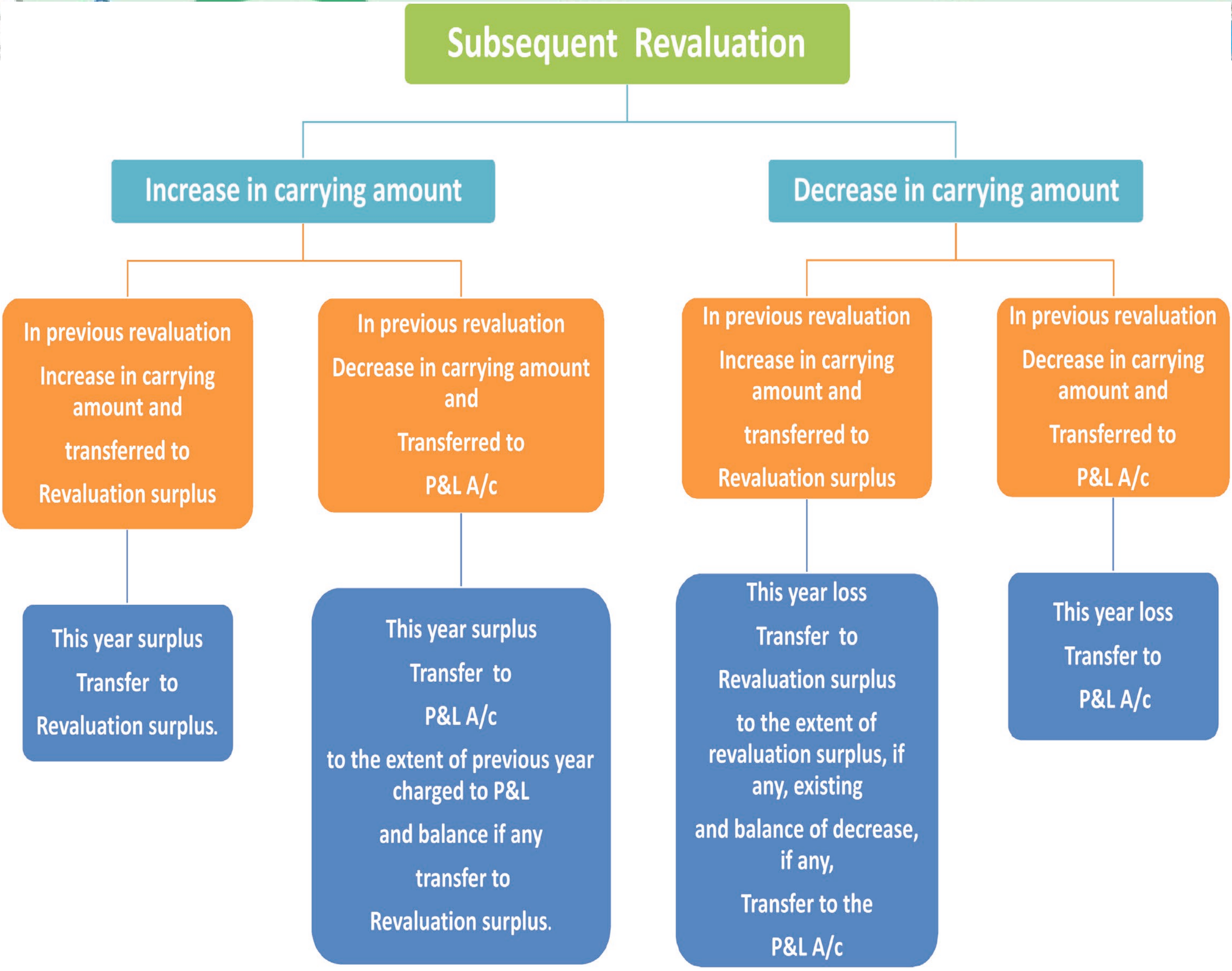
a) When there is increase in the carrying amount, credit to revaluation surplus

b) When there is decrease in the carrying amount, charge to the statement of profit and loss

## 2) Subsequent revaluation

a) **When there is increase in the carrying amount**, if the previous revaluation leads to increase in carrying amount and transferred to revaluation surplus, then credit this year surplus also to revaluation surplus. But if previous year revaluation lead to decrease in carrying amount and charged to P&L A/c, then credit this year increase to P&L to the extent of previous year charged to P&L and balance if any credit to revaluation surplus.

b) **When there is decrease in the carrying amount**, if the previous revaluation leads to increase in carrying amount and transferred to revaluation surplus, then charge this year loss to revaluation surplus to the extent of revaluation surplus, if any, existing and balance of decrease, if any, to the P&L. But if previous year revaluation lead to decrease in carrying amount and charged to P&L A/c, then credit this year decrease also to P&L A/c




- The revaluation surplus may be transferred directly to retained earnings when the asset is derecognised/ disposed of.

## Useful life/ Amortisation period

- An entity shall assess whether the useful life of an intangible asset is finite or indefinite.
- The term ‘indefinite’ does not mean ‘infinite’. It means firm can’t reliably asses the useful life of asset.
- Many factors are considered in determining the useful life of an intangible asset, including:

(a) The expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;

(b) Typical product life cycles for the asset and public information on estimates of useful lives of similar assets that are used in a similar way;

(c) Technical, technological, commercial or other types of obsolescence;

(d) The stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;

(e) Expected actions by competitors or potential competitors;

(f) The level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the entity's ability and intention to reach such a level;

(g) The period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and

(h) Whether the useful life of the asset is dependent on the useful life of other assets of the entity.

- If intangible asset having **defined useful life** then amortise the asset over the period of estimated useful life.
- The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight line method shall be used.
- The residual value of an intangible asset with a finite useful life shall 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;

  (b) There is an active market (as defined in Ind AS 113) 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.

- If intangible asset having indefinite useful life, then intangible asset with an indefinite useful life shall not be amortised.

## Retirements and disposals

An intangible asset shall be derecognised:

(a) On disposal; or

(b) When no future economic benefits are expected from its use or disposal.

The gain or loss arising from the de-recognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset.

For example, X ltd has software of carrying amount in books of accounts Rs 40,000. But due change in process, software is of no use for X ltd, so it decided to sell the software to Y ltd at Rs 25,000. The software is transferred in pen drive costing Rs 500. The loss from disposal of intangible asset is

Carrying amount – net proceeds
Rs 40,000 – (25,000 – 500)
Rs 15,500 ( loss)

# IND AS 40: INVESTMENT PROPERTY

- This Standard shall be applied in the recognition, measurement and disclosure of investment property.

## What is investment property?

- Investment property is property (land or a building—or part of a building—or both) held by the owner (or by the lessee under a finance lease) to earn rental income or for capital appreciation or both.

- For example, firm has a main business of manufacturing clothes, but it buys one building for investment purpose and give it on rent. Then that building will be covered under investment property rather than PPE.

- Examples of investment property:

  (a) Land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business.

  (b) Land held for a currently undetermined future use. (If an entity has not determined that it will use the land as owner-occupied property or for short-term sale in the ordinary course of business, the land is regarded as held for capital appreciation.)

  (c) A building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases.

  (d) A building that is vacant but is held to be leased out under one or more operating leases.

  (e) Property that is being constructed or developed for future use as investment property.

- The following land & buildings **can't be considered as on investment property** under the scope of this standard

  a. If any land & building is used by an entity in production or supply of goods/services during normal course of business (IND AS 16: PPE). Such type of property is a also called as "owner occupied property"

  b. If any property is held for short term appreciation (Ind AS-2: Inventory)

c. If any property is developed by real estate company for its sale in future during normal course of business (Ind AS-2: Inventory)

   Note: if any property is developed by building or real estate Company with the objective of rental income / letting it out then such property will be covered under this standard.

d. If any property, which was used by an entity in its business, but is held for sale now (Ind AS 105: Non-current assets held for sale)

e. If any property is held under construction contract by a contractor (Ind as 115: revenue from customer)

f. If any land or building is used in agricultural activities (Ind as 41: Agriculture)

g. if any land is used for extraction of mineral oils or ores (Ind as 106: Exploration for and Evaluation of Mineral Resources)

h. Property that is leased to another entity under a finance lease.

- If any property is used for **dual purpose** means it is partly used in business and partly let out then application of it will depend on following cases :-

**Case 1: If mixed property is separable**

In case property is separable then Ind AS 16 will be applied on the portion which is used in business, and remaining left out portion will be covered by Ind AS 40.

For example, D ltd, shirt manufacturer, buys two floor building. First floor is used as warehouse by X ltd whereas second floor is given on rent. So, first floor is treated as PPE and second floor as investment property.

As per the provisions, an investment property can be considered as separable only if a portion can be sold or given on finance lease without selling the other portion.

**Case 2: If property is not separable**

If portion of a property cannot be sold or given on finance lease without selling the other portion then it will be considered as a case of “inseparable property”. In the given case,

(i) If significant portion is used in business then Ind AS 16 will be applied.

(ii) If insignificant portion is used in business then Ind AS 40 will be applied.

For example, D ltd, shirt manufacturer, buy 1000 yard land

Let suppose D ltd use 980 yards for its business and remaining 20 yard is given on rent which is not separable. Then whole land will be considered as PPE.

Let suppose D ltd use only 30 yards for its business and remaining 970 yard is given on rent which is not separable. Then whole land will be considered as investment property.

- If an entity **provides ancillary services** to the occupants of a property it holds. An entity treats such a property as investment property if the services are insignificant to the arrangement as a whole.

  For example,

  (a) When the owner of an office building provides security and maintenance services to the lessees who occupy the building, the services are insignificant. So it will be considered as investment property.

  (b) If an entity owns and manages a hotel, services provided to guests are significant to the arrangement as a whole. Therefore, an owner-managed hotel is owner-occupied property, rather than investment property.

- In some cases, an entity owns property that is **leased to, and occupied by, its parent or another subsidiary**. Then
  - The property does not qualify as investment property in the consolidated financial statements, because the property is owner-occupied from the perspective of the group.
  - However, from the perspective of the entity that owns it, the property is investment property if it meets the definition of investment property. Therefore, the lessor treats the property as investment property in its individual financial statements.

## Recognition of investment property

- Recognition of investment property means when the investment property will be recorded in books of accounts.
- An investment property shall be recognised if, and only if:

  (e) It is probable that the expected future economic benefits that are attributable to the a investment property will flow to the entity; and

  (f) The cost of the investment property can be measured reliably.

## Initial recognition

(Value at which the investment property are recorded first time in books of accounts)

**Cases of acquisition of investment property**

- Purchased by cash
- Purchase on deferred credit
- Exchange of assets
- Held by lessee as right of use

**PURCHASED BY CASH**

- An investment property shall be measured initially at its cost. The cost of a purchased investment property comprises its

  a. Purchase price and

  b. Any directly attributable expenditure.

- Directly attributable expenditure includes, for example, professional fees for legal services, property transfer taxes and other transaction costs.

- Transaction costs shall be included in the initial measurement.
- The cost of an investment property will **not include**:
    a) Start-up costs (unless they are necessary to bring the property to the condition necessary for it to be capable of operating in the manner intended by management),
    b) Operating losses incurred before the investment property achieves the planned level of occupancy, or
    c) Abnormal amounts of wasted material, labour or other resources incurred in constructing or developing the property.

## PURCHASED ON DEFERRED CREDIT

- If payment for an investment property is deferred, its cost is the cash price equivalent i.e.
- Calculate present value of all future payments at market rate and recognise it as cost of acquired asset.
- The difference between this amount and the total payments is recognised as interest expense over the period of credit.

## EXCHANGE OF ASSSETS

- Investment property may be acquired in exchange of other asset.
- Cost of such an investment property is measured at fair value.
- Cost of an investment property is NOT measured at fair value if
    (c) The exchange transaction lacks commercial substance or
    (d) The fair value of neither the asset received nor the asset given up is reliably measurable.
- An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction.

- An exchange transaction has commercial substance if:

    (a) The configuration (i.e. risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

    (b) The portion of the entity's operations affected by the transaction changes as a result of the exchange; and

    (c) The difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

- If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

## HELD BY LESSEE AS RIGHT OF USE

The asset shall be recognised at the lower of the fair value of the property and the present value of the minimum lease payments.

# Measurement after recognition/ subsequent recognition

- An entity shall adopt as its accounting policy the cost model to all of its investment property i.e. cost less accumulated depreciation and accumulated impairment loss if any.
- If any expense is incurred in the form of repair & maintenance (i.e., day to day servicing) on investment property then such an expense will be written off in P&L A/c in the same year in which it is incurred. Such an expense can't be capitalised to the cost of property because it does not contribute to the appreciation in value of investment property, but these are incurred to maintain normal performance of an asset.
- If any expenditure is incurred on replacement or additions of assets then such expenditure can be capitalised to the cost of investment property because it is considered as a capital expenditure. Such expenditure is made to increase the value of property.

- This Standard requires all entities to measure the fair value of investment property, for the purpose of disclosure only.
- If an entity wants to report fair value then it has to follow Ind AS 113 fair value measurement rules.

## Transfers

- An entity shall transfer a property to, or from, investment property when, and only when, there is a change in use. A change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use.
- For example
  a) transfer from investment property to owner-occupied property
  b) transfer from investment property to inventories
  c) transfer from owner-occupied property to investment property
  d) transfer from inventories to investment property
  e) transfer from property in the course of construction/development to investment property
- There will be no journal entry in the books for such transfer, but disclosures shall be updated only according to appropriate heading.
- The transfer from one Ind AS to other will be made at "carrying amount" only. It means that there will be no measurement under previous Ind AS before making transfer of assets.
- After completing transfer process, measurement of property will be made as per new Ind AS.

## Disposals

- An investment property shall be derecognised (eliminated from the balance sheet) on disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal.

- Gains or losses arising from the retirement or disposal of investment property shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset and shall be recognised in profit or loss in the period of the retirement or disposal.

- Compensation from third parties for investment property that was impaired, lost or given up shall be recognised in profit or loss when the compensation becomes receivable.

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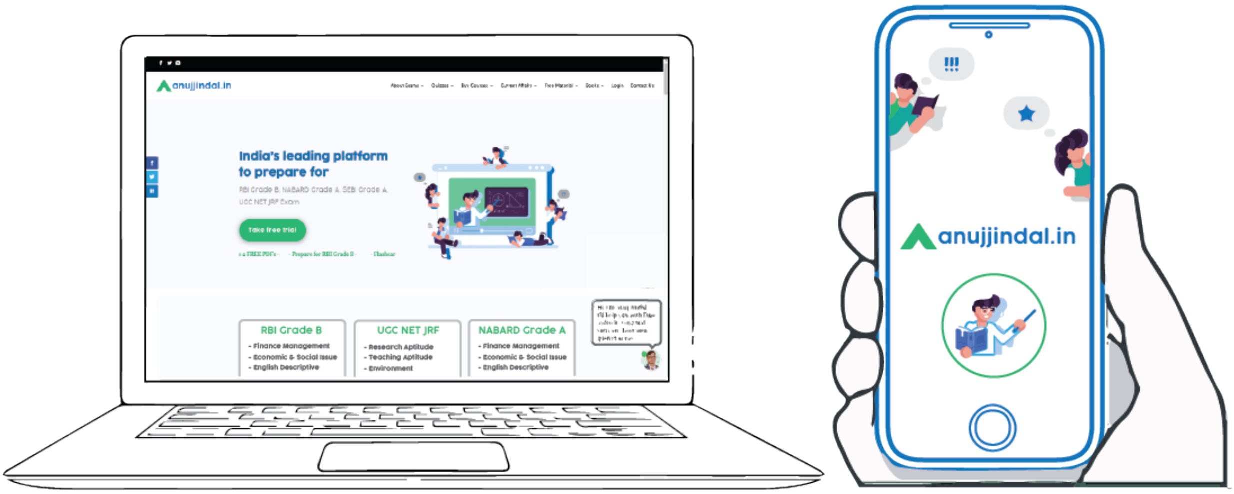

# “HALL OF FAME”

# RBI

| | |
|---|---|
| AIR 03 RBI : | Muhammad Ali |
| AIR 06 RBI : | Aditya Sood |
| AIR 10 RBI : | Sameer |
| AIR 11 RBI : | Abhishek |

550+ Students cleared RBI Phase 1

300+ Students clear RBI Phase 2

48 Students got selected in RBI

# SEBI

AIR 01 : Rajendra S

600+ Students cleared Phase 1

300+ Students cleared Phase 2

60+ Students selected in SEBI

# NABARD

NABARD

1100+ Students cleared Phase 1

250+ Students cleared Phase 2

30 Students selected in NABARD

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