Amended Accounting Standards

Accounting Standard – 2
Valuation of Inventories

Objective:

The objective of this standard is to formulate the method of computation of cost of inventories/stock, to determine the value of closing stock/ inventory at which, the inventory is to be shown in balance sheet till its' sale and recognition as revenue.

Accounting Standard-2 is not applicable in following cases:

- Work-in-progress arising under construction contract including directly related to service contract (AS-7 Construction contracts).
- Work-in-progress arising in ordinary course of business for service providers (Incomplete consultancy services, Incomplete merchant bank activities, Medical services in progress)
- Financial Instrument held as stock-in-trade (Shares, Debentures, Bonds etc.)
- Producer's inventories like livestock, agricultural and forest products, mineral oils, ores and gases. Such inventories are valued at net realisable value.

Inventories include:

- Held for sale in the ordinary course of business (finished goods)
- In the process of production of such sale (raw material and work-in-progress)
- In the form of materials or supplies to be consumed in production process or in the rendering of services (stores, spares, raw material, consumables).
- Inventories do not include machinery.

Spare parts and servicing equipments —

Inventories consists of—

- goods purchased and held for resale
- Inventories also consists finished goods produced, or work in progress being produced, by the enterprise and include materials, maintenance supplies, consumables and loose tools held for use in the production process.
- ***Inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS-10, Property, Plant and Equipment (PPE).***
- Machinery spares, not specific to a particular item of fixed asset and which can be used generally for various items of fixed assets, should be treated as inventories for the purpose of AS-2. Such machinery spares should be charged to the statement of profit and loss as and when issued for consumption in the ordinary course of operations.

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

Steps for valuation of Inventories:

1. Determination of cost of inventories;
2. Determination of net realisable value;
3. Comparison between the cost and net realisable value. The comparison should be made item by item or by group of items.

Cost of inventory consists the following —

1. Cost of purchase
2. Cost of conversion
3. Other costs incurred in bringing the inventories to their present location and condition

1. Cost of purchase includes —

- Purchase price, Duties and Taxes, Freight inward, other expenditures directly attributable to the acquisition.

Less:

- Duties and taxes recoverable by enterprises from taxing authorities, Trade discount, Rebate, Duty drawback, Other similar items.

2. Cost of conversion —

It consists of the cost directly related to the units + Systematic Allocation of fixed and variable production overheads that are incurred in converting material into finished goods.

Fixed Production overhead means Indirect cost of production that remains relatively constant regardless of volume of production. Allocation of fixed production overhead is done on normal capacity.

Variable Production overhead means indirect cost of production that varies directly or nearly directly with the volume of production. Allocation of variable production overhead is done on actual production.

In aces of Joint-products, when the cost of conversion of each product is not identifiable separately, total cost of conversion is allocated between the products on the rational and consistent basis.

If **by-products**, **scrap or waste materials** are not of material value, they are measured at net realisable value, then the net realisable value is deducted from cost of conversion. Net cost of conversion is distributed among the main products.

3. Other costs: Cost incurred in bringing the inventories to their present location and condition.

Items to be excluded from the cost of Inventories:

- Abnormal amounts of wasted materials, labour, other production costs;
- Storage cost;
- Administrative overhead;
- Selling and distribution cost;
- Interest and borrowing cost. However, if AS-16 allows such cost to be included it, can form part of the cost.

Cost formula

Specific identification method means directly linking the cost to the specific item of inventories.

If in any case, specific identification method is not applicable the cost of inventories is valued by the following methods:

✓ FIFO (First In First Out)

✓ Weighted Average cost.

When it is not practical to calculate the cost, the following methods may be followed to ascertain cost:

♦ Standard Cost

♦ Retail Method

Net Realisable Value —

Net realisable value means the estimated selling price in ordinary course of business, **less** estimated cost of completion and estimated cost necessary to make the sale. It is estimated on the basis of most reliable evidence at the time of valuation. The estimation of net realisable value also considers the purpose for which the inventory is held. The estimation is made as at each balance sheet date.

Estimation of net realisable value —

- ♦ If finished product in which raw material and supplies used is sold at cost or above cost, then the estimated realisable value of raw material and supplies is considered more than its cost. Therefore inventories of raw material will be valued at cost.

- ♦ If finished product in which raw material and supplies used is sold below cost. Then the estimated realisable value of raw material or supplies is equal to replacement price of raw material or supplies and this raw material will be valued at replacement price.

Disclosure in the financial statement

- Accounting policy adopted in measuring inventories.
- Cost formula used.
- ***Classifications of inventories are:***
  - **(i)** ***Raw materials and components***
  - **(ii)** ***Work-in-progress***
  - **(iii)** ***Finished goods***
  - **(iv)** ***Stock-in-trade (in respect of goods acquired for trading)***
  - **(v)** ***Stores and spares***
  - **(vi)** ***Loose tools***
  - **(vii)** ***Others (specify nature)***

Accounting Standard – 4
Contingencies and events occurring after the Balance Sheet date

This Standard deals with the treatment in financial statements of (a) contingencies, and (b) events occurring after the balance sheet date.
The following subjects, which may result in contingencies, are excluded from the scope of this standard in view of special considerations applicable to them:

a. liabilities of life assurance and general insurance enterprises arising from policies issued;
b. obligations under retirement benefit plans; and
c. commitments arising from long-term lease contracts.

The following terms are used in this Standard:

Contingency is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events.

Contingencies are of two types:

- Contingencies relating to existing condition or situation at the balance sheet date, the expected outcomes are two:
  - ✓ Contingent loss, it may be —
    - Probable Loss
    - Reasonably possible
    - Remote
  - ✓ Contingent gain, it is covered by AS - 29

- No accounting treatment is required, neither by way of provision nor by giving accounting notes.

Note:
- Probable - future event or events are likely to occur.
- Reasonably possible - chance of the future event or events occurring is more than remote but less than likely.
- Remote - chance of the future event or events occurring is slight.

Estimates are required for determining the amounts to be stated in the financial statements for many on-going and recurring activities of an enterprise. One must, however, distinguish between an event which is certain and one which is uncertain.

The estimates of the outcome and of the financial effect of contingencies are determined by the judgement of the management of the enterprise. This judgement is based on consideration of information available up to the date on which the financial statements are approved and will include a review of events occurring after the balance sheet date, supplemented by experience of similar transactions and, in some cases, reports from independent experts.

Provision for loss is estimated on the basis of information available up to the date of approval of accounts by competent authority. But the contingency must exist on the date of balance sheet. If contingency does not exist on balance sheet date no provision nor notes to accounts is required.

Accounting Treatment of Contingent Gains

Contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue which may never be realized. The contingent gains are not disclosed in the financial statements. If the realization of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate.

Events occurring after the Balance Sheet date are as under:—

- Events, which occur between the balance sheet date and date on which financial statements are approved by competent authority.

For the purpose of accounting treatment the events are classified in two categories.

- The events related to circumstances existing on the date of Balance Sheet — the loss should be accounted in the accounts and assets & liabilities to be adjusted. (Known as adjusting events)
- The events not related to circumstances existing on the date of Balance Sheet — to be disclosed by way of notes to accounts only, no adjustment in accounts are required. (Known as non-adjusting events)

Insolvency of a customer is an Adjusting event as insolvency of a customer, occurs after the balance sheet date usually, provides additional information on the condition that existed at the balance sheet date. Therefore, the carrying amount receivables should be adjusted for the event.
It is assumed that —
- The condition of insolvency existed at the balance sheet date
- The entity could not collect the complete information about the collectability of the receivable
- it could not estimate the insolvency of the customer

However, insolvency due to a major casualty occurring after the balance sheet date is not an adjusting event.

Event occurring after approval of accounts

Event occurring after the balance sheet date and also after approval of accounts by board of directors of a company such event should be disclosed in the director's report if material.

Disclosure

- The disclosure requirements herein referred to apply only in respect of those contingencies or events which affect the financial position to a material extent.

- If a contingent loss is not provided for, its nature and an estimate of its financial effect are generally disclosed by way of note unless the possibility of a loss is remote. If a reliable estimate of the financial effect cannot be made, this fact is disclosed.

- When the events occurring after the balance sheet date are disclosed in the report of the approving authority, the information given comprises the nature of the events and an estimate of their financial effects or a statement that such an estimate cannot be made.

Accounting Standard — 10
Property, Plant and Equipment

Objective:

The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can discern information about investment made by an enterprise in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

Scope / Applicability:

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

This Standard does not apply to:

a) Biological assets related to agricultural activity other than bearer plants. This Standard applies to bearer plants but it does not apply to the produce on bearer plants; and
b) Wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources.
   However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in (a) and (b) above.

Other Accounting Standards may require recognition of an item of property, plant and equipment based on an approach different from that in this Standard. For example, AS 19, Leases, requires an enterprise to evaluate its recognition of an item of leased property, plant and equipment on the basis of the transfer of risks and rewards.
However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.

Investment property, as defined in AS 13, Accounting for Investments, should be accounted for only in accordance with the cost model prescribed in this standard.

Important Terminology:

1. **Agricultural Activity** is the management by an enterprise of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.
2. **Agricultural Produce** is the harvested product of biological assets of the enterprise.
3. **Bearer plant** is a plant that:

a) is used in the production or supply of agricultural produce;
b) is expected to bear produce for more than a period of twelve months; and
c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

The following are not bearer plants:

a) plants cultivated to be harvested as agricultural produce (for example, trees grown for use as lumber);
b) plants cultivated to produce agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales (for example, trees that are cultivated both for their fruit and their lumber); and
c) annual crops (for example, maize and wheat).

When bearer plants are no longer used to bear produce they might be cut down and sold as scrap, for example, for use as firewood. Such incidental scrap sales would not prevent the plant from satisfying the definition of a bearer plant.

4. **Biological Asset** is a living animal or plant.
5. **Carrying amount** is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.
6. **Cost** is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Accounting Standards.
7. **Depreciable amount** is the cost of an asset, or other amount substituted for cost, less its residual value.
8. **Depreciation** is the systematic allocation of the depreciable amount of an asset over its useful life.
9. **Enterprise -specific value** is the present value of the cash flows an enterprise expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.
10. **Fair value** is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.
11. **Gross carrying amount** of an asset is its cost or other amount substituted for the cost in the books of account, without making any deduction for accumulated depreciation and accumulated impairment losses.
12. An **impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount.
13. **Property, plant and equipment** are tangible items that:

a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
b) are expected to be used during more than a period of twelve months.

14. **Recoverable amount** is the higher of an asset's net selling price and its value in use.
15. **The residual value** of an asset is the estimated amount that an enterprise would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.
16. **Useful life** is:

a) the period over which an asset is expected to be available for use by an enterprise ; or
b) the number of production or similar units expected to be obtained from the asset by an enterprise.

Recognition:

- 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 enterprise; and
  b) the cost of the item can be measured reliably.
- Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Standard when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.
- This Standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgment is required in applying the recognition criteria to specific circumstances of an enterprise.
- An enterprise evaluates under this recognition principle all its costs on property, plant and equipment at the time they are incurred. These costs include costs incurred:
  a) initially to acquire or construct an item of property, plant and equipment; and
  b) subsequently to add to, replace part of, or service it.

Initial Costs:

The definition of 'property, plant and equipment' covers tangible items which are held for use or for administrative purposes. The term 'administrative purposes' has been used in wider sense to include all business purposes other than production or supply of goods or services or for rental for others. Thus, property, plant and equipment would include assets used for selling and distribution, finance and accounting, personnel and other functions of an enterprise. Items of property, plant and equipment may also be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an enterprise to obtain the future economic benefits from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an enterprise to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired. For example, a chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the enterprise is unable to manufacture and sell chemicals. The resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with AS 28, Impairment of Assets.

Subsequent Costs:

- Under the recognition principle (as mentioned above), an enterprise does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-today servicing of the item. Rather, these costs are recognised in the statement of profit and loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of such expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment.
- Parts of some items of property, plant and equipment may require replacement at regular intervals or it may require replacement several times. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement or to make a non-recurring replacement. Under the recognition principle (as discussed above), an enterprise recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the 'derecognition provisions' of this Standard.

- A condition of continuing to operate an item of property, plant and equipment may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection is derecognised.
- The derecognition of the carrying amount occurs regardless of whether the cost of the previous part / inspection was identified in the transaction in which the item was acquired or constructed. If it is not practicable for an enterprise to determine the carrying amount of the replaced part/ inspection, it may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/ existing inspection component was when the item was acquired or constructed.

Measurement at Recognition:

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

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 and condition necessary for it to be capable of operating in the manner intended by management.
(c) the initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'decommissioning, restoration and similar liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Measurement of Cost:

- The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is capitalised in accordance with AS 16.
- One or more items of property, plant and equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an item of property, plant and equipment is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable.
  The acquired item(s) is/are measured in this manner even if an enterprise cannot immediately derecognise the asset given up. If the acquired item(s) is/are not measured at fair value, its/their cost is measured at the carrying amount of the asset(s) given up.
- An enterprise 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 (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 enterprise-specific value of the portion of the operations of the enterprise affected by the transaction changes as a result of the exchange;

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

- For the purpose of determining whether an exchange transaction has commercial substance, the enterprise -specific value of the portion of operations of the enterprise affected by the transaction should reflect post-tax cash flows. In certain cases, the result of these analyses may be clear without an enterprise having to perform detailed calculations.
- The fair value of an asset is reliably measurable if (a) the variability in the range of reasonable fair value measurements is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value. If an enterprise is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.
- Where several items of property, plant and equipment are purchased for a consolidated price, the consideration is apportioned to the various items on the basis of their respective fair values at the date of acquisition. In case the fair values of the items acquired cannot be measured reliably, these values are estimated on a fair basis as determined by competent valuers.

Measurement after Recognition:

An enterprise should choose either the cost model or the revaluation model as its accounting policy and should apply that policy to an entire class of property, plant and equipment. It is discussed hereunder:

(a) Cost Model:

After recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

(b) Revaluation Model:

- After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.
- The fair value of items of property, plant and equipment is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers.
- If there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment and the item is rarely sold, except as part of a continuing business, an enterprise may need to estimate fair value using an income approach (for example, based on discounted cash flow projections) or a depreciated replacement cost approach which aims at making a realistic estimate of the current cost of acquiring or constructing an item that has the same service potential as the existing item.
- The frequency of revaluations depends upon the changes in fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required. Some items of property, plant and equipment experience significant and volatile changes in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant changes in fair value. Instead, it may be necessary to revalue the item only every three or five years.

- When an item of property, plant and equipment is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:
  a. the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset; or
  b. the accumulated depreciation is eliminated against the gross carrying amount of the asset.
- If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs should be revalued.
- The items within a class of property, plant and equipment are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates. However, a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period and provided the revaluations are kept up to date.
- An increase in the carrying amount of an asset arising on revaluation should be credited directly to owners' interests under the heading of revaluation surplus. However, the increase should be recognised in the statement of profit and loss to the extent that it reverses a revaluation decrease of the same asset previously recognized in the statement of profit and loss.
- A decrease in the carrying amount of an asset arising on revaluation should be charged to the statement of profit and loss. However, the decrease should be debited directly to owners' interests under the heading of revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset.
- The revaluation surplus included in owners' interests in respect of an item of property, plant and equipment may be transferred to the revenue reserves when the asset is derecognised. This may involve transferring the whole of the surplus when the asset is retired or disposed of. However, some of the surplus may be transferred as the asset issued by an enterprise. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on its original cost. Transfers from revaluation surplus to the revenue reserves are not made through the statement of profit and loss.

Depreciation:

- Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately.
- An enterprise allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates each such part separately. For example, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.
- A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.
- To the extent that an enterprise depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant. If an enterprise has varying expectations for these parts, approximation techniques may be necessary to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of its parts.
- An enterprise may choose to depreciate separately the parts of an item that do not have a cost that is significant in relation to the total cost of the item.
- The depreciation charge for each period should be recognised in the statement of profit and loss unless it is included in the carrying amount of another asset.

- The depreciation charge for a period is usually recognised in the statement of profit and loss. However, sometimes, the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (see AS 2). Similarly, the depreciation of property, plant and equipment used for development activities may be included in the cost of an intangible asset recognised in accordance with AS 26, Intangible Assets.

Depreciable Amount and Depreciation Period:

- The depreciable amount of an asset should be allocated on a systematic basis over its useful life.
- The residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.
- Depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount. Repair and maintenance of an asset do not negate the need to depreciate it.
- The depreciable amount of an asset is determined after deducting its residual value.
- The residual value of an asset may increase to an amount equal to or greater than its carrying amount. If it does, depreciation charge of the asset is zero unless and until its residual value subsequently decreases to an amount below its carrying amount.
- 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 at the earlier of the date that the asset is retired from active use and is held for disposal and the date that the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use (but not held for disposal) unless the asset is fully depreciated. However, under usage methods of depreciation, the depreciation charge can be zero while there is no production.
- The future economic benefits embodied in an asset are consumed by an enterprise principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:
    a. expected usage of the asset. Usage is assessed by reference to the expected capacity or physical output of the asset.
    b. expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.
    c. technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.
    d. legal or similar limits on the use of the asset, such as the expiry dates of related leases.
- The useful life of an asset is defined in terms of its expected utility to the enterprise. The asset management policy of the enterprise may involve the disposal of assets after as pecified time or after consumption of a specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter

than its economic life. The estimation of the useful life of the asset is a matter of judgment based on the experience of the enterprise with similar assets.

- Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. 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.
- If the cost of land includes the costs of site dismantlement, removal and restoration, that portion of the land asset is depreciated over the period of benefits obtained by incurring those costs. In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits to be derived from it.

Depreciation Method:

- The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.
- The depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.
- A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the residual value of the asset does not change. 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. The enterprise selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits or that the method is changed in accordance with the statute to best reflect the way the asset is consumed.
- A depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate. The revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits of the asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed.

Changes in Existing Decommissioning, Restoration and Other Liabilities:

- The cost of property, plant and equipment may undergo changes subsequent to its acquisition or construction on account of changes in liabilities, price adjustments, changes in duties, changes in initial estimates of amounts provided for dismantling, removing, restoration and similar factors and included in the cost of the asset. Such changes in cost should be accounted for as under:

<u>If the related asset is measured using the cost model</u>:

- ✓ Changes in the liability should be added to, or deducted from, the cost of the related asset in the current period.
- ✓ The amount deducted from the cost of the asset should not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess should be recognised immediately in the statement of profit and loss.

- ✓ If the adjustment results in an addition to the cost of an asset, the enterprise should consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the enterprise should test the asset for impairment by estimating its recoverable amount, and should account for any impairment loss, in accordance with AS 28.

<u>If the related asset is measured using the revaluation model:</u>

- ✓ Changes in the liability alter the revaluation surplus or deficit previously recognised on that asset, so that:
  - a decrease in the liability should be credited directly to revaluation surplus in the owners' interest, except that it should be recognised in the statement of profit and loss to the extent that it reverses a revaluation deficit on the asset that was previously recognised in the statement of profit and loss;
    An increase in the liability should be recognised in the statement of profit and loss, except that it should be debited directly to revaluation surplus in the owners' interest to the extent of any credit balance existing in the revaluation surplus in respect of that asset.
- ✓ In the event that a decrease in the liability exceeds the carrying amount that would have been recognised had the asset been carried under the cost model, the excess should be recognised immediately in the statement of profit and loss.
- ✓ A change in the liability is an indication that the asset may have to be revalued in order to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Any such revaluation should be taken into account in determining the amounts to be taken to the statement of profit and loss and the owners' interest. If are valuation is necessary, all assets of that class should be revalued.
  The adjusted depreciable amount of the asset is depreciated over its useful life. Therefore, once the related asset has reached the end of its useful life, all subsequent changes in the liability should be recognised in the statement of profit and loss as they occur. This applies under both the cost model and the revaluation model.

Impairment:

To determine whether an item of property, plant and equipment is impaired, an enterprise applies AS 28, Impairment of Assets. AS 28 explains how an enterprise reviews the carrying amount of its assets, how it determines the recoverable amount of an asset, and when it recognises, or reverses the recognition of, an impairment loss.

Compensation for Impairment:

- Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up should be included in the statement of profit and loss when the compensation becomes receivable.
- Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:

  - ✓ Impairments of items of property, plant and equipment are recognized in accordance with AS 28;
  - ✓ Derecognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard;
  - ✓ Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up is included in determining profit or loss when it becomes receivable; and

- ✓ The cost of items of property, plant and equipment restored, purchased or constructed as replacements is determined in accordance with this Standard.

Retirements:
Items of property, plant and equipment retired from active use and held for disposal should be stated at the lower of their carrying amount and net realizable value. Any write-down in this regard should be recognised immediately in the statement of profit and loss.

Derecognition:

- The carrying amount of an item of property, plant and equipment should be derecognised
  - ✓ on disposal; or
  - ✓ when no future economic benefits are expected from its use or disposal.
- The gain or loss arising from the derecognition of an item of property, plant and equipment should be included in the statement of profit and loss when the item is derecognised (unless AS 19, Leases, requires otherwise on a sale and leaseback).Gains should not be classified as revenue, as defined in AS 9, Revenue Recognition.
- However, an enterprise that in the course of its ordinary activities, routinely sells items of property, plant and equipment that it had held for rental to others should transfer such assets to inventories at their carrying amount when they cease to be rented and become held for sale. The proceeds from the sale of such assets should be recognised in revenue in accordance with AS 9, Revenue Recognition.
- The disposal of an item of property, plant and equipment may occur in a variety of ways (e.g. by sale, by entering into a finance lease or by donation). In determining the date of disposal of an item, an enterprise applies the criteria in AS 19 for recognizing revenue from the sale of goods. AS 19, Leases, applies to disposal by a sale and lease back.
- If, under the recognition principle, an enterprise recognises in the carrying amount of an item of property, plant and equipment the cost of a replacement for part of the item, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it is not practicable for an enterprise to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.
- The gain or loss arising from the derecognition 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.
- The consideration receivable on disposal of an item of property, plant and equipment is recognised in accordance with the principles enunciated in AS 9.

Disclosure:

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

loss in accordance with AS 28;impairment losses reversed in the statement of profit and loss in accordance with AS 28;depreciation;the net exchange differences arising on the translation of the financial statements of a non-integral foreign operation in accordance with AS 11, The Effects of Changes in Foreign Exchange Rates; and other changes.

- The financial statements should also disclose: the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities; the amount of expenditure recognised in the carrying amount of an item of property, plant and equipment in the course of its construction; the amount of contractual commitments for the acquisition of property, plant and equipment; if it is not disclosed separately on the face of the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in the statement of profit and loss; and the amount of assets retired from active use and held for disposal.
- Selection of the depreciation method and estimation of the useful life of assets are matters of judgement. Therefore, disclosure of the methods adopted and the estimated useful lives or depreciation rates provides users of financial statements with information that allows them to review the policies selected by management and enables comparisons to be made with other enterprises. For similar reasons, it is necessary to disclose: depreciation, whether recognised in the statement of profit and loss or as a part of the cost of other assets, during a period; and accumulated depreciation at the end of the period.
- In accordance with AS 5, an enterprise discloses the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods. For property, plant and equipment, such disclosure may arise from changes in estimates with respect to: residual values; the estimated costs of dismantling, removing or restoring items of property, plant and equipment; useful lives; and depreciation methods.
- If items of property, plant and equipment are stated at revalued amounts, the following should be disclosed: the effective date of the revaluation; whether an independent valuer was involved; the methods and significant assumptions applied in estimating fair values of the items; the extent to which fair values of the items were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques; and the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.
- An enterprise is encouraged to disclose the following: the carrying amount of temporarily idle property, plant and equipment; the gross carrying amount of any fully depreciated property, plant and equipment that is still in use; for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; the carrying amount of property, plant and equipment retired from active use and not held for disposal.

Translation Provisions:

- Where an entity has in past recognized an expenditure in the statement of profit and loss which is eligible to be included as a part of the cost of a project for construction of property, plant and equipment in accordance with the requirements, it may do so retrospectively for such a project. The effect of such retrospective application of this requirement, should be recognised net-of-tax in revenue reserves.
- The requirements regarding the initial measurement of an item of property, plant and equipment acquired in an exchange of assets transaction should be applied prospectively only to transactions entered into after this Standard becomes mandatory.
- On the date of this Standard becoming mandatory, the spare parts, which hitherto were being treated as inventory under AS 2, Valuation of Inventories, and are now required to

be capitalised in accordance with the requirements of this Standard, should be capitalised at their respective carrying amounts. The spare parts so capitalised should be depreciated over their remaining useful lives prospectively as per the requirements of this Standard.

- The requirements regarding the revaluation model should be applied prospectively. In case, on the date of this Standard becoming mandatory, an enterprise does not adopt the revaluation model as its accounting policy but the carrying amount of item(s) of property, plant and equipment reflects any previous revaluation it should adjust the amount outstanding in the revaluation reserve against the carrying amount of that item. However, the carrying amount of that item should never be less than residual value. Any excess of the amount outstanding as revaluation reserve over the carrying amount of that item should be adjusted in revenue reserves.

Accounting Standard — 13
Accounting for Investments

Investment is the assets held for earning income by way of dividend, interest and rentals, for capital appreciation or for other benefits to the investing enterprise. Assets held as stock-in-trade are not 'investments'.

1. This Standard deals with accounting for investments in the financial statements of enterprises and related disclosure requirements.
2. This Standard does not deal with:

(a) the bases for recognition of interest, dividends and rentals earned on investments which are covered by Accounting Standard 9 on Revenue Recognition;
(b) operating or finance leases;
(c) investments of retirement benefit plans and life insurance enterprises; and
(d) mutual funds and venture capital funds and/or the related asset management companies, banks and public financial institutions.

The following terms are used in this Standard with the meanings assigned:

Current investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made.

Long term investment is an investment other than a current investment.

Investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise. For example, if a company purchases land or building not for its business use but for earning the rent by letting the land or building, the land or building is not fixed asset but it is an investment or even if building is not let out but held with the intention to earn capital appreciation, then it is an investment.

Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction. Under appropriate circumstances, market value or net realisable value provides an evidence of fair value.

Market value is the amount obtainable from the sale of an investment in an open market, net of expenses necessarily to be incurred on or before disposal.

Classification of investment

Investment is classified as long-term investment and current investment as defined above.

Cost of Investment

- The cost of an investment includes acquisition charges such as brokerage, fees and duties.
- If an investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost is the fair value of the securities issued. The fair value may not necessarily be equal to the nominal or par value of the securities issued.
- If an investment is acquired in exchange, or part exchange, for another asset, the acquisition cost of the investment is determined by reference to the fair value of the asset given up. It may be appropriate to consider the fair value of the investment acquired if it is more clearly evident.
- When interest has accrued in pre-acquisition period and was included in cost of investment at the time of acquisition, then subsequent receipt of such pre-acquisition interest is deducted from the cost of investment.
- Dividend - When dividend is declared from pre-acquisition profits, and later on received by the purchaser of investment, then such amount of dividend is deducted from the cost of investment.
- When right shares offered are subscribed for, the cost of the right shares is added to the carrying amount of the original holding. If rights are not subscribed for but are sold in the market, the sale proceeds are taken to the profit and loss statement. However, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value.

Carrying amount of investment —

Current investment

Carrying amount of each current investment is the lower of cost and realisable value.
Any reduction in realisable value is debited to profit and loss account and if realisable value of investment is increased subsequently, the increase in value of current investment to the level of the cost is credited to profit and loss account.

Long-term investment

- It is usually carried / valued at cost.
- If there is a decline in value of investment and, if such decline is not temporary, then carrying amount of investment is reduced by the amount of such decline. The resultant reduction in carrying amount is charged to the profit and loss account. This reduction amount is reversed when there is a rise in the value of investment but such rise in value should not be temporary.

- Indicators of the value of an investment:
  (a) its market value,
  (b) the investee's assets and results,
  (c) the expected cash flows from the investment,
  (d) the type and extent of the investor's stake in the investee,
  (e) restrictions on distribution by the investee or on disposal by the investor.

Investment Property

An investment property is accounted for in accordance with cost model as prescribed in Accounting Standard (AS) 10, Property, Plant and Equipment. The cost of any shares in a co-operative society or a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property.

Disposal of Investment

- When an investment is disposed of, the difference between the carrying amount and net sale proceeds (gross sale less expenses) is recognized in the profit and loss account.

- When only a part of total investment is disposed of, the carrying amount of that part of investment is determined on the basis of the average carrying amount of the total investment.

Reclassification of Investments

- Where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.
- Where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.

Disclosures:

- the accounting policies for the determination of carrying amount of investments.

- the amounts included in profit and loss statement for:
  (i) interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments. Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes Paid;
  (ii) profits and losses on disposal of current investments and changes in carrying amount of such investments;
  (iii) profits and losses on disposal of long-term investments and changes in the carrying amount of such investments;

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

- the aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments;

- other disclosures as specifically required by the relevant statute governing the enterprise.

Accounting Standard — 14
Accounting for Amalgamation

This standard deals with accounting for amalgamations and the treatment of any resultant goodwill or reserves. This standard is directed principally to companies although some of its requirements also apply to financial statements of other enterprises.

This standard does not deal with cases of acquisitions which arise when there is a purchase by one company (referred to as the acquiring company) of the whole or part of the shares, or the whole or part of the assets, of another company (referred to as the acquired company) in consideration for payment in cash or by issue of shares or other securities in the acquiring company or partly in one form and partly in the other. The distinguishing feature of an acquisition is that the acquired company is not dissolved and its separate entity continues to exist.

Purchase consideration

As the Transferee Company is purchasing the business of Transferor Company, the transferee company pays purchase consideration to the transferor company. Which means total of the shares and other securities issued and payment made in form of cash or other assets given by the transferee company to shareholders of the transferor company.

Types of amalgamation

There are two types of amalgamation:

- Amalgamation in the nature of merger;
- Amalgamation in the nature of purchase.

Conditions to be satisfied for **Amalgamation in the nature of merger**:

- Business of the transferor company is intended to be carried on by the transferee company.
- All assets and liabilities of Transferor Company are taken over by the transferee company.
- The shareholders holding at least 90% or more of the equity shares of the transferor company become the equity shareholder of the transferee company, shares already held by the transferee company and its subsidiaries are not counted for the purpose of 90% or more limit.
- Consideration for the amalgamation is paid in equity shares by the transferee company to the equity shareholder of the transferor company and fractional shares can be paid in cash.
- No adjustment is made in the book values of the assets and liabilities of the transferor company by way of revaluation or otherwise, except the adjustments to ensure uniformity of accounting policies.

Amalgamation in the nature of purchase:

If any of the conditions regarding amalgamation in the nature of merger is not satisfied.

Methods of Accounting

- in case of merger - pooling interest method
- in case of purchase - purchase method

AS-14 does not mention, how accounting is to be made in Transferor Company's books in that case accounting as per common practice has to be done , irrespective of the type of amalgamation.

Pooling interest method —

- After amalgamation in preparation of the financial statement of the transferee company, line by line addition of assets and liabilities of should be made except for share capital.

- The difference between purchase consideration paid and the amount of share capital (equity + preference capital) of the transferor company should be adjusted with reserves.

- If purchase consideration is more than the share capital of the transferor company, then amount shall be debited to reserves, if reverse is the case, the difference is credited to reserves.

Purchase Method —

- If any of the conditions of merger is not satisfied, then the amalgamation shall be classified as purchase, therefore the purchase method of accounting shall be followed.

- In the books of transferee company assets and liabilities shall be recorded at the value at which these assets and liabilities are taken over by the transferee; assets do not include fictitious assets and liabilities do not include inside/internal liabilities.

- If purchase consideration exceeds the net assets taken over (Net Assets = Assets at their agreed value less liabilities at agreed value), the difference is debited to Goodwill account. If purchase consideration is less, the difference is credited to capital reserve.

Treatment of Statutory Reserves

Statutory Reserves are those reserves, which are created as per the particular statute/law, under that law, the reserve is created and this law puts some restriction on utilisation and maintenance of reserves for a particular period.

- Separate accounting adjustment/entry is not required for statutory reserves in the case of merger, in case of amalgamation by way of purchase, the reserves being internal liabilities, are not recorded in the books of transferee.

- To comply with the requirements of particular statute, the statutory reserves created in the books of transferor company is to be maintained for some more years in the transferee company books. In that case transferee company shall record the statutory reserves in its books by debiting to amalgamation adjustment reserve and crediting statutory reserve. When the maintenance of statutory reserves is no longer required, the entry passed should be reversed.

- ***Amalgamation adjustment reserve shall be presented in balance sheet as a separate line item as there is not any sub-heading like 'miscellaneous expenditure' in Schedule III of The Companies Act, 2013.***

Goodwill arising on Amalgamation — Treatment

It is considered appropriate to amortize goodwill over a period not exceeding five years unless a somewhat longer period can be justified. The requirement of AS-26 intangible asset regarding amortization shall not apply to such goodwill.

Disclosure

In first financial statement of transferee company the following disclosures are made for all amalgamation:

- Names and general nature of business of amalgamating companies;
- Effective date of amalgamation;
- Method of accounting applied;
- Particulars of scheme sanctioned under a law.

Amalgamation accounted under pooling interest method—

- description and number of shares issued,
- difference between consideration and net assets acquired and treatment thereof

Amalgamation accounted under purchase method—

- Consideration for the amalgamation.
- Difference between consideration and net assets acquired and treatment thereof. including period of amortization of goodwill.

Note: Amalgamation as per this Accounting Standard means an amalgamation pursuant to the provisions of the Companies Act, 2013 or any other law/statute which is applicable to companies, it also includes 'merger'.

Accounting Standard — 21
Accounting for Amalgamation

Objective

The objective of this Standard is to lay down principles and procedures for preparation and presentation of consolidated financial statements. Consolidated financial statements are presented by a parent/ holding enterprise to provide financial information about the economic activities of its group to show the economic resources controlled by the group, the obligations of the group and results the group achieves with its resources.

Scope

1. This Standard should be applied in the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent.

2. It should also be applied in accounting for investments in subsidiaries in the separate financial statements of a parent.

3. In the preparation of consolidated financial statements, other Accounting Standards also apply in the same manner as they apply to the separate statements.

4. This Standard does not deal with:

   (a) methods of accounting for amalgamations and their effects on consolidation, including goodwill arising on amalgamation;
   (b) accounting for investments in associates; and
   (c) accounting for investments in joint ventures.

Relevant terms:

Control:

(a) the ownership, directly or indirectly through subsidiary(ies), of more than one-half of the voting power of an enterprise; or
(b) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities.

Subsidiary: Subsidiary is an enterprise that is controlled by another enterprise.
Parent: A parent is an enterprise that has one or more subsidiaries.
Group: A group is a parent and all its subsidiaries.
Consolidated financial statements: These are the financial statements of a group presented as those of a single enterprise.
Equity: It is the residual interest in the assets of an enterprise after deducting all its liabilities.

Minority Interest: It is that part of the net results of operations and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiary(ies), by the parent.

Consolidated financial statements normally include consolidated balance sheet, consolidated statement of profit and loss, and notes, other statements and explanatory material that form an integral part thereof. Consolidated cash flow statement is presented in case a parent presents its own cash flow statement.

Presentation of Consolidated Financial Statements

Users of the financial statements of a parent are usually concerned with, and need to be informed about, the financial position and results of operations of not only the enterprise itself but also of the group as a whole. For this the parent **should present a separate financial statement of the parent** and **consolidated financial statements**, which present financial information about the group as that of a single enterprise without regard to the legal boundaries of the separate legal entities.

Scope of Consolidated Financial Statements

A parent should consolidate all subsidiaries, domestic as well as foreign.

A subsidiary should be excluded from consolidation when:

(a) control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future; or
(b) it operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent. In consolidated financial statements, investments in such subsidiaries should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments. The reasons for not consolidating a subsidiary should be disclosed in the consolidated financial statements.

Consolidation Procedures:

- In preparing consolidated financial statements, the financial statements of the parent and its subsidiaries should be combined on a line by line basis by adding together like items of assets, liabilities, income and expenses.

- Steps of consolidation :

(a) the cost to the parent of its investment in each subsidiary and the parent's portion of equity of each subsidiary, at the date on which investment in each subsidiary is made, should be eliminated;
(b) any excess of the cost of investment in a subsidiary over the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made, should be described as goodwill to be recognised as an asset in the consolidated financial statements and in the reverse case the difference should be treated as a capital reserve in the consolidated financial statements;
(c) Minority interest: should be calculated and shown in the consolidated financial statements separately in separate head. It means the portion of net assets of subsidiary on the date of consolidation not controlled by the parent or through its subsidiary.
Minority interest = paid up equity capital held by outsider + share of reserve and surplus on the date of consolidation. Preference share capital not held by parent or group is also considered.

(d) minority interests in the net income of consolidated subsidiaries for the reporting period should be identified and adjusted against the income of the group in order to arrive at the net income attributable to the owners of the parent;
(e) When minority interest comes in negative, this should be adjusted against majority interest. In other words, negative minority interest will not be shown in consolidated balance sheet. If the subsidiary subsequently reports profits, all such profits should be allocated to majority interest until minority share of losses previously absorbed by the majority is recovered.
(f) If an enterprise makes two or more investments in another enterprise at different dates and eventually obtains control of the other enterprise, the consolidated financial statements are presented only from the date on which holding-subsidiary relationship comes in existence. If small investments are made over a period of time and then an investment is made that results in control, the date of the latest investment, as a practicable measure, may be considered as the date of investment.
(g) Intragroup balances and intragroup transactions and resulting unrealised profits should be eliminated in full. Unrealised losses resulting from intragroup transactions are also eliminated unless cost cannot be recovered.
(h) Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full.

Consolidation at different reporting date :

Financial statement of parents and its subsidiary used for consolidation are generally of same date, however when reporting dates are different and it is not practical to prepare the financial statements of subsidiary of the same date, the different reporting date financial statement can be consolidated making adjustment for the effects of significant transactions that occur between those dates and parent financial statements provided difference is not more than **six months.**
If parent and its subsidiaries are following different accounting policies, the consolidated financial statement should be prepared using uniform accounting policies, if it is not practicable, then the items in which different accounting policies have been followed should be disclosed.

Disposal of investment in a subsidiary:

The difference between the proceeds from the disposal of investments in a subsidiary and the carrying amount of its assets less liabilities as of the date of disposal is recognized in the consolidated statement.

Successive purchase of shares in a subsidiary by the parent/ purchase in lot:

If an enterprise purchases two or more times the investment of other enterprises and gradually obtains control of the other enterprise the consolidated financial statement is prepared from the date on which holding subsidiary relationship is established. Further, in such cases goodwill or capital reserve on consolidation should be determined on step by step basis, however if small investments are made over a period of time, then the date of latest major investment which resulted in control, should be considered as date of investment.

If there are **arrears of cumulative preference share** of a subsidiary then the holding company share of profits is calculated after charging the arrear of cumulative preference dividend of a subsidiary, whether declared or not.

Disclosure:

(a) a list of all subsidiaries including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held;
(b) in consolidated financial statements, where applicable:
  (i) the nature of the relationship between the parent and a subsidiary, if the parent does not own, directly or indirectly through subsidiaries, more than 50% of the voting power of the subsidiary;
  (ii) the effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date, the results for the reporting period and on the corresponding amounts for the preceding period; and
  (iii) the names of the subsidiary(ies) of which reporting date(s) is/are different from that of the parent and the difference in reporting dates.

Transitional Provisions

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

Accounting Standard — 29

Provisions, Contingent Liabilities and Contingent

Objective

The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities and that sufficient information is disclosed in the notes to the financial statements. The objectives of this Standard is also to lay down appropriate accounting for contingent assets.

Scope

1. This Standard should be applied in accounting for provisions and contingent liabilities and in dealing with contingent assets, except:
   (a) those resulting from financial instruments that are carried at fair value;
   (b) those resulting from executory contracts, except where the contract is onerous;
   (c) those arising in insurance enterprises from contracts with policy-holders; and
   (d) those covered by another Accounting Standard.
2. This Standard applies to financial instruments (including guarantees) that are not carried at fair value.
3. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. This Standard does not apply to executory contracts unless they are onerous.
4. This Standard applies to provisions, contingent liabilities and contingent assets of insurance enterprises other than those arising from contracts with policy-holders.
5. This Standard defines provisions as liabilities which can be measured only by using a substantial degree of estimation. The term 'provision' is also used in the context of items such as depreciation, impairment of assets and doubtful debts: these are adjustments to the carrying amounts of assets and are not addressed in this Standard.
6. Other Accounting Standards specify whether expenditures are treated as assets or as expenses. These issues are not addressed in this Standard. Accordingly, this Standard neither prohibits nor requires capitalisation of the costs recognised when a provision is made.

7. This Standard applies to provisions for restructuring (including discontinuing operations). Where a restructuring meets the definition of a discontinuing operation, additional disclosures are required by AS 24,

Provision is a liability, which can be measured only by using a substantial degree of estimation that means to become provision it must be a liability.

A liability is present obligation of the enterprise arising from past events , settlement of which is expected to result in an outflow of resources embodying economic benefits. That means to become a liability there must be present obligation.

Present obligation - An obligation is a present obligation if based on evidence available, its existence on the balance sheet date is considered probable ie. more likely than not.

As per US GAAP "Probable" indicates "Likely to occur" whereas this is not the case in AS-29 which refers probable as - 'more likely than not'.

Example of provision: Mitra Ltd. manufactures and sells radios under the terms of the contract of sale, the manufacturer repairs or replaces, manufacturing defects that become apparent within two years from the date of the sale and makes good. Now, it is probable (more likely than not) that there will be some claims under these warranties.

Provisions for Onerous Contracts - As a consequence of limited revision of AS-29 "Provisions, Contingent Liabilities and Contingent Assets" the scope of this Accounting Standard has been widened to include in its ambit the "Onerous Contract". Now in respect of accounting periods commencing on or after April 1, 2006 Provision for Onerous Contract are required in Accounts. **'Onerous Contract'** is a contract in which the unavoidable costs of meeting the obligation under the contract exceed the economic benefits expected to be recovered under it.

Requirement

- In the above case there is present obligation as a result of past obligating event —the past event is the sale of the radios, which gives rise to a present obligation.
- An outflow of resources embodying economic benefits in settlement is probable for the warranties as a whole.
- No doubt for recognition of provision, reliable estimate of warranties has to be made.

Contingent liability is:

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

(b) a present obligation that arises from past events but is not recognised because:
   (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
   (ii) a reliable estimate of the amount of the obligation cannot be made.

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

Present obligation - an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

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

Provision for Restructuring Cost

It should be noted that the AS-29 does not prescribe the accounting of restructuring cost. It only prescribes the recognition and measurement criteria for 'provision for restructuring cost'.

Restructuring - As per AS-29 "restructuring" is a programme that is planned and controlled by management and materially changes either —

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

Examples of restructuring —

- Sale or termination of line of business.
- closure of business locations in a country or region
- Relocation of business activities from one country or region to another.
- Change in management structure etc.

Restructuring cost - Provision for restructuring cost should include only the Direct Expenditures arising from restructuring and not associated with the ongoing activities of the enterprises.

Exclusions from restructuring cost —

- The cost of retraining or relocating continuing staff;
- Marketing cost;
- Investment in new system and distribution network;
- Expected loss on sale of assets due to restructuring. However, these assets will be subject to impairment as per AS-28.

Recognition

Provisions

A provision should be recognised only when:

(a) an enterprise has a present obligation as a result of a past event;
(b) it must exist on balance sheet date;
(c) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
(d) a reliable estimate can be made of the amount of the obligation.

For contingent liability the existence of possible obligation should be 'Not Probable' whereas for 'Provisions' it should be 'Probable'.

Any event will be tested for provision and contingent liability in the same way and therefore "Provision" is recognised for the best estimate of the amount to settle the obligation as it is "Probable".

Provision should be used only for those expenditures for which the provision was created.

Accounting treatment: The amount of provision should be shown as an expense in profit and loss statement. Any expenses relating to provision should be shown in profit and loss statement net of reimbursement.

The amount of provision outstanding at the end should be shown in liability side without netting off reimbursement, the reimbursement expected is to be shown as an asset in the balance sheet.

Contingent liability

An enterprise should not recognise the contingent liability, it should be disclosed in financial statement.

Conditions to be fulfilled for disclosure in financial statement —

- There should be present obligation arising out of past event, but not recognised as a provision.
- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- The possibility of an outflow of resources embodying economic benefits is not remote.
- If amount of the obligation cannot be measured with sufficient reliability to be recognised as provision.

Contingent Asset

An enterprise should not recognise a contingent asset because it may result in the recognition of income that may never be realized. If realisation is virtually certain then it is recognised. Contingent assets are not required to be disclosed in financial statement, generally it is disclosed in Board of Directors report.

Transitional Provisions - All the existing provisions for decommissioning, restoration and similar liabilities should be discounted prospectively, with the corresponding effect to the related item of property, plant and equipment.

Disclosure of provision in financial statements —

- Opening balance
- Addition to and use of the provision
- Unused amount written back
- Closing balance

Other required disclosures are —

- brief description of provision
- Major assumption on future events made at the time of measuring the provision and indication of uncertain items.
- Any expected reimbursement is to be recognised as an asset.

Disclosure of contingent liability at the balance sheet date —

- description of the nature of the contingent liability;
- where required, an estimate of the amount as per measurement principles as prescribed for provision;
- indications of the uncertainties relating to outflow;
- possibility of any reimbursement;
- Where any of the information required as above is not disclosed because, that fact should be stated.