Accounting Standards Marathon

Specially for CA Inter Students

Colourful Notes with Charts of Group -II

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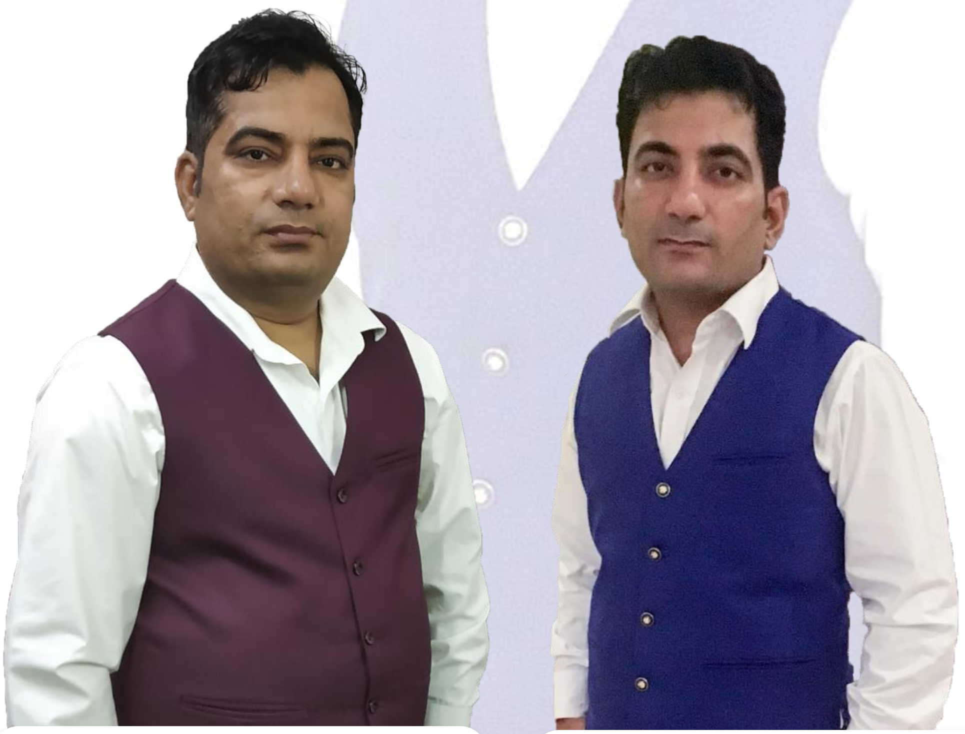
Also applicable for CMA Inter Students



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AS-4 Contigencies & Events occurring after Balance Sheet Date

Introduction

AS 4 (Revised) deals with the treatment and disclosure requirements in the financial statements of events occurring after the balance sheet

Contingencies

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

Accounting Treatment of Contingent Losses

- *The accounting treatment of a contingent loss is determined by the expected outcome of the contingency*
- *If it is likely that a contingency will result in a loss to the enterprise, then it is prudent to provide for that loss in the financial statements.*

Example: *ABC has filed case against a debtor for a recovery of ` 25 Lakhs. According to the legal team, the chances of recovery is nil. Therefore, ABC should make provision for doubtful debt.*

The estimation of the amount of a contingent loss to be provided for in the financial statements, may be based on judgement made, by management. If there is conflicting or insufficient evidence for estimating the amount of a contingent loss, then disclosure is made of the existence and nature of the contingency

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 realised*
- *However, when the realisation of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate*
- *The amount at which a contingency is stated in the financial statements is based on the information which is available at the date on which the financial statements are approved.*

Events Occurring after the Balance Sheet Date

- *Events occurring after the balance sheet date are those significant events,*
- *Both favourable and unfavourable,*
- *That occur between the balance sheet date and the date on which the financial statements are approved*
- *By the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity.*

For example, for the year ending on 31st March 2011, financial statement is finalized and approved by the Board of the directors of the company in its meeting held on 04th September 2011. In this case the events taking place between 01st April 2011 to 04th September 2011 are termed as events occurring after the balance sheet date.

Two types of events can be identified:

1) *Adjusting events- those which provide further evidence of conditions that existed at the balance sheet date. For example, a trade receivable declared insolvent after reporting date and unable to pay full amount against whom provision for doubtful debt was created.*
2) *Non-adjusting events- those which are indicative of conditions that arose subsequent to the balance sheet date. For example, plant got damaged due to occurrence of fire*

Adjusting Events

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

Non-Adjusting Events

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

Dividend declared after balance sheet date

- *There are events which, although take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature*
- *For example, if dividends are declared after the balance sheet date but before the financial statements are approved, the dividends are not recognised as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. **Such dividends are disclosed in the notes***
- *Thus, no liability for proposed dividends needs to be recognised in financial statements for financial year ended 31st March, 2017 and subsequent years. Such proposed dividends are to be disclosed in the notes as per Companies (Accounting Standards) Amendment Rules, 2016 issued on 30 March 2016*

Events indicating going concern assumption inappropriate

- *Events occurring after the balance sheet date may indicate that the enterprise ceases to be a going concern*
- *A deterioration in operating results and financial position, or unusual changes affecting the existence or substratum of the enterprise after the balance sheet date (e.g., destruction of a major production plant by a fire after the balance sheet date) may indicate a need to consider whether it is proper to use the fundamental accounting assumption of going concern in the preparation of the financial statements*

In case the going concern assumption is not valid (based on events occurring after the balance sheet date), the financial statements are prepared on a liquidation basis

AS-5 Net Profits or Loss for the Period, Prior Period Items & Extra Ordinary Items

Objective of AS-5

⇒ *The objective of AS 5 is to prescribe the classification and disclosure of certain items in the statement of profit and loss so that all enterprises prepare and present such a statement on a uniform basis*

⇒ *This enhances the comparability of the financial statements of an enterprise over time and with the financial statements of other enterprises*

⇒ *Accordingly, AS 5 requires the classification and disclosure of extraordinary and prior period items, and the disclosure of certain items within profit or loss from ordinary activities*

It also specifies the accounting treatment for changes in accounting estimates and the disclosures to be made in the financial statements regarding changes in accounting policies

Net Profits or Loss for the Period

All items of income and expense which are recognized in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise.

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

Profit or loss from ordinary activities

Any activities which are undertaken by an enterprise

- *as part of its business and*
- *Such related activities in which the enterprise engages in furtherance of,*
- *Incidental to, or*
- *Arising from, these activities*

Example *Profit on sale of goods, loss on sale of unsold inventory at the end of the season*

Extraordinary items

What is EOI

Income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly

Treatment

Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period

Disclosure

The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current P/L can be perceived

Exceptional items

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

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

The write-down of inventories to net realisable value as well as the reversal of such write-downs

a) A restructuring of the activities of an enterprise and the reversal of any provisions for the costs of restructuring
b) Disposals of items of fixed assets
c) Disposals of long-term investments
d) Legislative changes having retrospective application
e) Litigation settlements
f) Other reversals of provisions

PRIOR PERIOD ITEMS

What is PPI

*Prior period items are income or expenses **which arise in the current period** as a result of errors or omissions in the preparation of the financial statements of one or more prior periods*

Errors

Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, mis-interpretation of facts, or oversight

Treatment &Disclosur

The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current P/L can be perceived

Imp Note:

⇒ *An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss*

⇒ *In either case, the objective is to indicate the effect of such items on the current profit or loss*

CHANGES IN ACCOUNTING ESTIMATES

- ⇒ *An estimate may have to be revised if changes occur in the circumstances **based on which the estimate was made,** or as a result of new information, more experience or subsequent developments*
- ⇒ *The revision of the estimate, by its nature, does not bring the adjustment within the definitions of an extraordinary item or a prior period item*
- ⇒ *Accounting estimates by their nature are approximations that may need revision as additional information becomes known. For example, income or expense recognised on the outcome of a contingency which previously could not be estimated reliably does not constitute a prior period item*

CHANGES IN ACCOUNTING POLICIES

Accounting policies are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

Accounting Policies can be changed only when

- *The adoption of a different accounting policy is required by statute*
- *For compliance with an accounting standard*
- *To Give true and fair view of presentation to the financial statement of the enterprise*

The following are not changes in accounting policies:

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

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

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

AS-7 Construction Contracts

Construction Contracts

- *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*
- *A construction contract may be negotiated for the construction of a single asset such as a bridge, building, dam, pipeline, road, ship or tunnel*
- *A construction contract may also deal with the construction of a number of assets which are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use; examples of such contracts include those for the construction of refineries and other complex pieces of plant or equipment.*

For the purposes of this Standard, construction contracts also include:

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

Types of Construction Contracts

As per AS 7, the outcome of fixed price contracts can be estimated reliably when all the following conditions are satisfied:

1. *Total contract revenue can be measured reliably*
2. *It is probable that the economic benefits associated with the contract will flow to the enterprise*
3. *Both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and*
4. *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.*

The outcome of a cost plus contract can be estimated reliably when all the following conditions are satisfied:

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

Percentage Completion Method

Question: -

- *KCC Ltd. commenced a construction contract on 01/04/21*
- *The contract price agreed was reimbursable cost plus 10%*
- *The company incurred ` 10,00,000 in 2021-22, of which cost of ` 9,00,000 is reimbursable*
- *The further non-reimbursable costs to be incurred to complete the contract are estimated at ` 50,000*
- *The other costs to complete the contract could not be estimated reliably*

Treatment of Cost relating to future activity

Uncollectable Contract Revenue

Question: -2- Show Profit & Loss A/c (Extract) in books of a contractor in respect of the following data

	` 000
Contract price(Fixed)	*600*
Cost incurred to date	*390*
Estimated cost to complete	*260*

Question:3 *- A firm of contractors obtained a contract for construction of bridges across river Revathi. The following details are available in the records kept for the year ended 31st March, 2011*

	(` in lakhs)
Total Contract Price	1,000
Work Certified for the cost incurred	500
Work yet not Certified for the cost incurred	105
Estimated further Cost to Completion	495
Progress Payment Received	400
To be Received	140

AS-9 Revenue Recognition

Attempt	May-18	Nov-18	May-19	Nov-19	Nov-20
Marks	-----	----	5	5	-------

Applicability *AS 9 is mandatory for all enterprises*

AS 9 deals with the bases for recognition of revenue in the statement of profit and loss of an enterprise. The Standard is concerned with the recognition of revenue arising in the course of the ordinary activities of the enterprise from

AS 9 deal with

- The sale of goods
- The rendering of services
- The use by others of enterprise resources yielding interest, royalties and dividends

AS 9 does not deal with

- Revenue arising from construction contracts
- Revenue arising from hire-purchase, lease agreements
- Revenue arising from government grants and other similar subsidies
- Revenue of insurance companies arising from insurance contracts

Sale of Goods

⇒ *Revenue from sales transactions should be recognised when the requirements as to performance set out in below paragraph are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection*

⇒ *If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.*

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

The seller of goods has transferred to the buyer the property in the goods for a price

↓

All significant risks and rewards of ownership have been transferred to the buyer

↓

The seller retains no effective control of the goods transferred to a degree usually associated with ownership

↓

No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods

Rendering of Services

Revenue from service transactions is usually recognised as the service is performed. There are two methods of recognition of revenue from service transaction, viz

Services

Proportionate Completion Method

1	*Revenue recognises in the P/L A/c proportionately with the degree of completion of services under a Contract*
2	*Here performance consists of the execution of more than one act*
3	*Revenue is recognised proportionately by reference to the performance of each act*
4	*Revenue is recognised when the sole or final act takes place and the service becomes chargeable*

Completed Service Contract Method

1	*Revenue recognises in the P/L A/c only when the rendering of services under a contract is **Completed or Substantially Completed***
2	*In this method performance consists of the execution of a single act e.g. installation of a machine, or repair service*

Conditions:

1. *Revenue from sales or service transactions should be recognised when the service is performed provided that at the time of performance it is not unreasonable to expect ultimate collection*
2. *If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed*

Income from other sources - Interest, Royalties and Dividends

Use by others of such enterprise resources gives rise to:

1) ***Interest:*** *charges for the use of cash resources or amounts due to the enterprise. Revenue is recognised on a time proportion basis taking into account the amount outstanding and the rate applicable.*

2) ***Royalties:*** *charges for the use of such assets as know-how, patents, trade marks and copyrights. Revenue is recognized on an accrual basis in accordance with the terms of the relevant agreement.*

3) ***Dividends:*** *rewards from the holding of investments in shares. Revenue is recognized when the owner's right to receive payment is established.*

Revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends should only be recognized when no significant uncertainty as to measurability or collectability exists

Effect of Uncertainties on Revenue Recognition

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

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

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

Disclosure

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

Qus:1 -

- ⇒ *The Board of Directors decided on 31.3.2012 to increase the sale price of certain items retrospectively from 1st January, 2012*
- ⇒ *In view of this price revision with effect from 1st January 2012, the company has to receive ₹15 lakhs from its customers in respect of sales made from 1st January, 2012 to 31st March, 2012*
- ⇒ *Accountant cannot make up his mind whether to include ₹15 lakhs in the sales for 2011-2012*

Advise.

Qus:2 –

- ⇒ *Y Ltd., used certain resources of X Ltd.*
- ⇒ *In return X Ltd. received ₹20 lakhs and ₹35 lakhs as interest and royalties respective from Y Ltd. during the year 2011-12.*

You are required to state whether and on what basis these revenues can be recognized by X Ltd

AS-14 Accounting for Amalgamations

Definition

1. *__Amalgamation__ means an amalgamation pursuant to the provisions of the Companies Act, 2013 or any other statute which may be applicable to companies and includes 'merger'.*
2. *__Transferor__ company means the company which is amalgamated into another company.*
3. *__Transferee__ company means the company into which a transferor company is amalgamated.*

Types of Amalgamations

Amalgamations fall into two broad categories

1. *__Merger__ - In amalgamations where there is a genuine pooling not merely of the assets and liabilities of the amalgamating companies but also of the shareholders' interests and of the businesses of these companies.*
2. *__Purchase -__ In amalgamations which are in effect a mode by which one company acquires another company and as a consequence the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company, or the business of the company which is acquired is not intended to be continued. Such amalgamations are amalgamations in the nature of 'purchase'.*

Amalgamation in the Nature of Merger

Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions.

1. *All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.*
2. *Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.*
3. *The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.*
4. *The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.*
5. *No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.*

Amalgamation in the Nature of Purchase

Amalgamation in the nature of purchase is an amalgamation which does not satisfy any one or more of the conditions specified above for "Amalgamation in the nature of merger

Methods of Accounting of Amalgamations

There are two main methods of accounting for amalgamations.

1. *For an amalgamation in the nature of merger - pooling of interests method and*
2. *For an amalgamation in the nature of purchase - purchase method.*

Pooling rate of Interests Method

- *Pooling of interests is a method of accounting for amalgamations the object of which is to account for the amalgamation as if the separate businesses of the amalgamating companies were intended to be continued by the transferee company*
- *Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies.*
- *Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts*
- *If, at the time of the amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with AS 5.*

Purchase Method

Under the purchase method, the transferee company accounts for the amalgamation either

1. *By incorporating the assets and liabilities at their existing carrying amounts or*
2. *By allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.*

Consideration

- *Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company*
- *In determining the value of the consideration, an assessment is made of the fair value of its elements*
- *Many amalgamations recognise that adjustments may have to be made to the consideration in the light of one or more future events*
- *When the additional payment is probable and can reasonably be estimated at the date of amalgamation, it is included in the calculation of the consideration*
- *In all other cases, the adjustment is recognised as soon as the amount is determinable*

Treatment of Reserves of the Transferor Company on Amalgamation

- *If the amalgamation is an 'amalgamation in the nature of merger', the identity of the reserves is preserved and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company.*
- *Thus, for example, the General Reserve of the transferor company becomes the General Reserve of the transferee company, the Capital Reserve of the transferor company becomes the Capital Reserve of the transferee company and the Revaluation Reserve of the transferor company becomes the Revaluation Reserve of the transferee company. As a result of preserving the identity, reserves which are available for distribution as dividend before the amalgamation would also be available for distribution as dividend after the amalgamation.*

Adjustments to reserves-Merger

When an amalgamation is accounted for using the pooling of interests method, the reserves of the transferee company are adjusted to give effect to the following:

- ✓ *A uniform set of accounting policies should be adopted following the amalgamation and, hence, the policies of the transferor and the transferee are aligned.*
- ✓ *Difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company.*

Adjustments to reserves-Purchase

Treatment of Goodwill arising on Amalgamation

Goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised to income on a systematic basis over its useful life. Due to the nature of goodwill, it is frequently difficult to estimate its useful life with reasonable certainty. Such estimation is, therefore, made on a prudent basis. Accordingly, it is considered appropriate to amortise goodwill over a period not exceeding five years unless a somewhat longer period can be justified.

Factors which may be considered in estimating the useful life of goodwill arising on amalgamation include:

a) *the foreseeable life of the business or industry*
b) *the effects of product obsolescence, changes in demand and other economic factors*
c) *the service life expectancies of key individuals or groups of employees*
d) *expected actions by competitors or potential competitors*
e) *legal, regulatory or contractual provisions affecting the useful life*

AS-18 Related Party Disclosures

Introduction

- *AS 18 prescribes the requirements for disclosure of related party relationship and transactions between the reporting enterprise and its related parties*
- *The requirements of the standard apply to the financial statements of each reporting enterprise as also to consolidated financial statements presented by a holding company*

Related Party Relationships

Related party - parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions

AS 18 deals only with related party relationships described in (a) to (e) below:

a) *Enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries).*

b) *Associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture.*

c) *Individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual.*

d) *Key management personnel and relatives of such personnel and*

e) *Enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.*

In the context of AS 18, the following are deemed not to be related parties:

a) *Two companies simply because they have a director in common (unless the director is able to affect the policies of both companies in their mutual dealings).*

b) *A single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence and*

The parties listed below, in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of the enterprise or participate in its decision-making process):

i. *Providers of finance*
ii. *Trade unions*
iii. *Public utilities*
iv. *Government departments and government agencies including government sponsored bodies*

Related Party Issue

- *Related party relationships are a normal feature of commerce and business*
- *Without related party disclosures, there is a general presumption that transactions reflected in financial statements are consummated on an arm's-length basis between independent parties*
- *However, that presumption may not be valid when related party relationships exist because related parties may enter into transactions which unrelated parties would not enter into*
- *Also, transactions between related parties may not be effected at the same terms and conditions as between unrelated parties*
- *Sometimes, no price is charged in related party transactions, for example, free provision of management services and the extension of free credit on a debt*
- *In view of the aforesaid, the resulting accounting measures may not represent what they usually would be expected to represent. Thus, a related party relationship could have an effect on the financial position and operating results of the reporting enterprise*

Definitions of other Terms used in AS 18

Related party transaction: A transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

Control:

a) Ownership, directly or indirectly, of more than one half of the voting power of an enterprise, or
b) Control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or
c) A substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise.

For the purpose of AS 18, an enterprise is considered to control the composition of the board of directors of a company or governing body of an enterprise, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors/members of the governing body of that company/enterprise. An enterprise is deemed to have the power to appoint a director/ member of the governing body, if any of the following conditions is satisfied:

a) A person cannot be appointed as director/member of the governing body without the exercise in his favour by that enterprise of such a power as aforesaid or
b) A person's appointment as director/member of the governing body follows necessarily from his appointment to a position held by him in that enterprise or
c) The director/member of the governing body is nominated by that enterprise; in case that enterprise is a company, the director is nominated by that company/subsidiary thereof.

An enterprise is considered to have a substantial interest in another enterprise if that enterprise owns, directly or indirectly, 20% or more interest in the voting power of the other enterprise. Similarly, an individual is considered to have a substantial interest in an enterprise, if that individual owns, directly or indirectly, 20 per cent or more interest in the voting power of the enterprise.

An Associate: An enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of that party.

Significant influence: Participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies . It may be exercised in several ways, for example, by representation on the board of directors, participation in the policy making process, material inter-company transactions, interchange of managerial personnel or dependence on technical information. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investing party holds, *directly or indirectly through intermediaries, 20 per cent or more of the voting power of the enterprise, it is presumed that the investing party does have significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investing party holds, directly or indirectly through intermediaries, less than 20% of the voting power of the enterprise, it is presumed that the investing party does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investing party does not necessarily preclude an investing party from having significant influence*

Key Management Personnel: *Those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise*

For example, in the case of a company, the managing directors, whole time directors, manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.

A non-executive director of a company should not be considered as a key management person by virtue of merely his being a director unless he has the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.

The requirements of AS 18 should not be applied in respect of a non-executive director even if he participates in the financial and/or operating policy decision of the enterprise, unless he falls in any of the categories of 'related party relationships' discussed above.

Relative: *In relation to an individual, means the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by, that individual in his/her dealings with the reporting enterprise.*

Joint Venture - *a contractual arrangement whereby two or more parties undertake an economic activity which is subject to joint control.*

Joint Control*– the contractually agreed sharing of power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.*

Holding Company*– a company having one or more subsidiaries. Subsidiary – a company:*

a) *in which another company (the holding company) holds, either by itself and/or through one or more subsidiaries, more than one-half, in nominal value of its equity share capital; or*
b) *of which another company (the holding company) controls, either by itself and/or through one or more subsidiaries, the composition of its board of directors.*

Fellow subsidiary– *a company is considered to be a fellow subsidiary of another company if both are subsidiaries of the same holding company.*

Disclosure

Name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between the related parties

This is to enable users of financial statements to form a view about the effects of related party relationships on the enterprise.

If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

i. *The name of the transacting related party;*
ii. *A description of the relationship between the parties;*
iii. *A description of the nature of transactions;*
iv. *Volume of the transactions either as an amount or as an appropriate proportion;*
v. *Any other elements of the related party transactions necessary for an understanding of the financial statements;*
vi. *The amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date;*
vii. *Amounts written off or written back in the period in respect of debts due from or to related parties.*

Items of a similar nature may be disclosed in aggregate by type of related party except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the reporting enterprise.

Remuneration paid to key management personnel should be considered as a related party transaction requiring disclosures. In case non-executive directors on the Board of Directors are not related parties, remuneration paid to them should not be considered a related party transaction

AS-19 Leases

Lease

A Lease is an agreement whereby the Lessor (legal owner of an asset) conveys to the Lessee (another party) in return for a payment or series of periodic payments (Lease rents), the right to use an asset for an agreed period of time

Applicability of AS 19

The standard applies to all leases other than:

1. *lease agreements to explore for or use of natural resources, such as oil, gas, timber metals and other mineral rights; and*
2. *licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights; and*
3. *lease agreements to use lands*

Types of Leases

For accounting purposes, leases are classified as:

1) *Finance leases; and*
2) *Operating leases*

1. ***Finance lease** - A lease classified as Finance Lease if it transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not be eventually transferred.*
2. ***Operating Lease** -A lease is classified as an Operating Lease if it does not transfer substantially all the risk and rewards incident to ownership.*

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

Indicators of Finance Lease

Situations, which would normally lead to a lease being classified as a finance lease are:

1. *The lease transfers ownership of the asset to the lessee by the end of the lease term*
2. *The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised*
3. *The lease term is for the major part of the economic life of the asset even if title is not transferred*
4. *The lease term is for the major part of the economic life of the asset even if title is not transferred*
5. *At the inception of the lease, present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and*
6. *The leased asset is of a specialized nature such that only the lessee can use it without major modifications being made*

Additional Indicators of situations which individually or in combination could also lead to a lease being classified as a finance lease are:

a) *If the lessee can cancel the lease and the lessor's losses associated with the cancellation are borne by the lessee*
b) *If gains or losses from the fluctuations in the residual value accrue to the lessee (for example if the lessor agrees to allow rent rebate equaling most of the disposal value of leased asset at the end of the lease); and*
c) *If the lessee can continue the lease for a secondary period at a rent, which is substantially lower than market rent*

Books of Lessee

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AS-19-LEASES

Question: -Milind Softex Ltd. has taken the assets on lease from ABC Impex Ltd. The following information is given below:

Lease Term = 4 years
Fair value at inception of lease = ` 16,00,000
Lease Rent = ` 5,00,000 p.a. at the end of year
Guaranteed Residual Value = ` 1,00,000
Expected Residual Value = ` 2,00,000
Implicit Interest Rate = 14.97%

How the accounting is done in the book of lessor & Lessee ?

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AS-19-LEASES

AS-20 Earnings Per Share

Attempt	May-18	Nov-18	May-19	Nov-19	Nov-20
Marks	5	5	------	5	-------

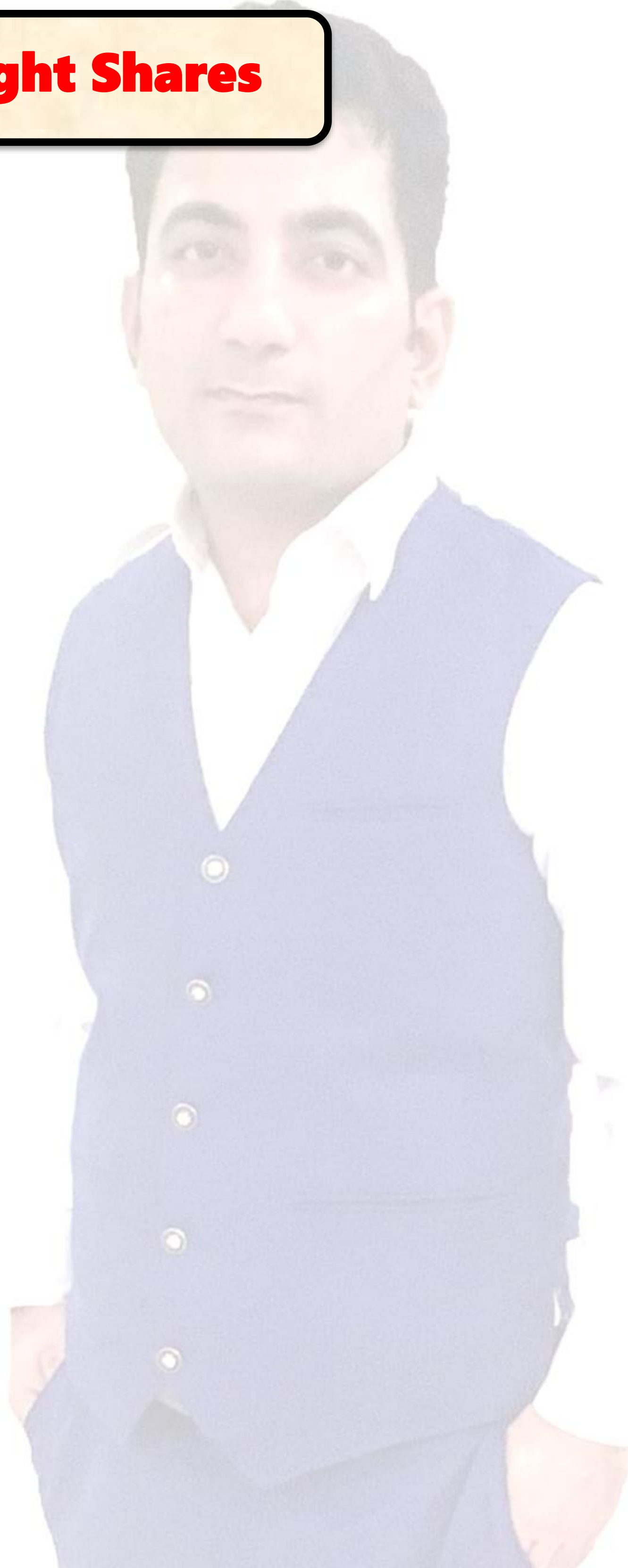
Basic Earnings Per Share

Time Adjustments

Paid up Value Adjustments

Bonus Shares

Right Shares



Adjusted EPS

Question -

- *Net profit for the year 2019 -₹ 11,00,000*
- *Net profit for the year 2020 -₹ 15,00,000*
- *No. of shares outstanding prior to rights issue - 5,00,000 shares*
- *Rights issue price - ₹ 15.00*
- *Last date to exercise rights - 1st March 2020*
- *Rights issue is one new share for each five outstanding (i.e. 1,00,000 new shares)*
- *Fair value of one equity share immediately prior to exercise of rights on 1st March 2020 was ₹ 21.00.*

Compute Basic Earnings Per Share

Dilluted EPS

AS-26 Intangible Assets

Scope of AS-26

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

a. *Intangible assets that are covered by another Accounting Standard For example, AS 26 does not apply to:*
   - a) *Intangible assets held by an enterprise for sale in the ordinary course of business (AS 2 and AS 7)*
   - b) *Deferred tax assets (AS 22)*
   - c) *Leases that fall within the scope of AS 19*
   - d) *Goodwill arising on an amalgamation (AS 14 (Revised)) and goodwill arising on consolidation (AS 21 (Revised))*

b. *Financial assets*

c. *Mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources and*

d. *Intangible assets arising in insurance enterprises from contracts with policyholders*

However, AS 26 applies to other intangible assets used (such as computer software), and other expenditure (such as start-up costs), in extractive industries or by insurance enterprises.

AS 26 also applies to:

a) *Expenditure on advertising, training, start - up cost*

b) *Research and development activities*

c) *Right under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts*

d) *Patents, copyrights and trademarks*

Definitions

An asset *is a resource:*

a) *Controlled by an enterprise as a result of past events and*
b) *From which future economic benefits are expected to flow to the enterprise .*

Monetary assets *are money held and assets to be received in fixed or determinable amounts of money.*

Non-monetary assets *are assets other than monetary assets.*

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

Depreciable amount *is the cost of an asset less its residual value.*

Useful life *is either:*

a) *The Period of time over which an asset is expected to be used by the enterprise; or*
b) *The number of production or similar units expected to be obtained from the asset by the enterprise .*

Carrying amount *is the amount at which an asset is recognised in the balance sheet, net of any accumulated Amortisation and accumulated impairment losses thereon.*

A financial asset *is any asset that is:*

a) *Cash,*
b) *A contractual right to receive cash or another financial asset from another enterprise,*
c) *A contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable or*
d) *An ownership interest in another enterprise.*

Intangible Assets

An intangible asset is

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

Identifiability

- *The definition of an intangible asset requires that an intangible asset be identifiable. To be identifiable, it is necessary that the intangible asset is clearly distinguished from goodwill.*
- *An intangible asset can be clearly distinguished from goodwill if the asset is separable which means that enterprise could rent, sell, exchange or distribute the specific future economic benefits attributable to the asset without also disposing of future economic benefits that flow from other assets used in the same revenue earning activity*
- *Separability is not a necessary condition for identifiability. If an asset generates future economic benefits only in combination with other assets, the asset is identifiable if the enterprise can identify the future economic benefits that will flow from the asset*

Future Economic Benefits

- *The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the enterprise.*
- ***For example,*** *the use of intellectual property in a production process may reduce future production costs rather than increase future revenues.*

Recognition and Initial Measurement of an Intangible Asset

The recognition of an item as an intangible asset requires an enterprise to demonstrate that the item meets the definition of an intangible asset and recognition criteria set out as below:

a) *It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and*
b) *The cost of the asset can be measured reliably. An intangible asset should be measured initially at cost.*

An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over the useful life of the asset.

An intangible asset should be measured initially at cost

Recognition of an Expense

Amortisation Period

Amortisation Method

A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include

1. *The straight-line method,*
2. *The diminishing balance method and*
3. *The unit of production method.*

Residual Value

Question: –

- ⇒ *A company acquired a patent at a cost of ₹160 lakhs for a period of 5 years and the product life cycle is also 5 years.*
- ⇒ *The company capitalized the cost and started amortising the asset at ₹16 lakhs per year based on the economic benefits derived from the product manufactured under the patent.*
- ⇒ *After 2 years it was found that the product life cycle may continue for another 5 years from then (the patent is renewable and the company can get it renewed after 5 years).*
- ⇒ *The net cash flows from the product during these 5 years were expected to be ₹50 lakhs, ₹30 lakhs, ₹60 lakhs, ₹70 lakhs and ₹40 lakhs.*

Find out the amortization cost of the patent for each of the years.

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AS-26 Intangible Assets

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