# CA - IPCC COURSE MATERIAL

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## **ACCOUNTING STANDARDS IN ITS SIMPLEST FORM**

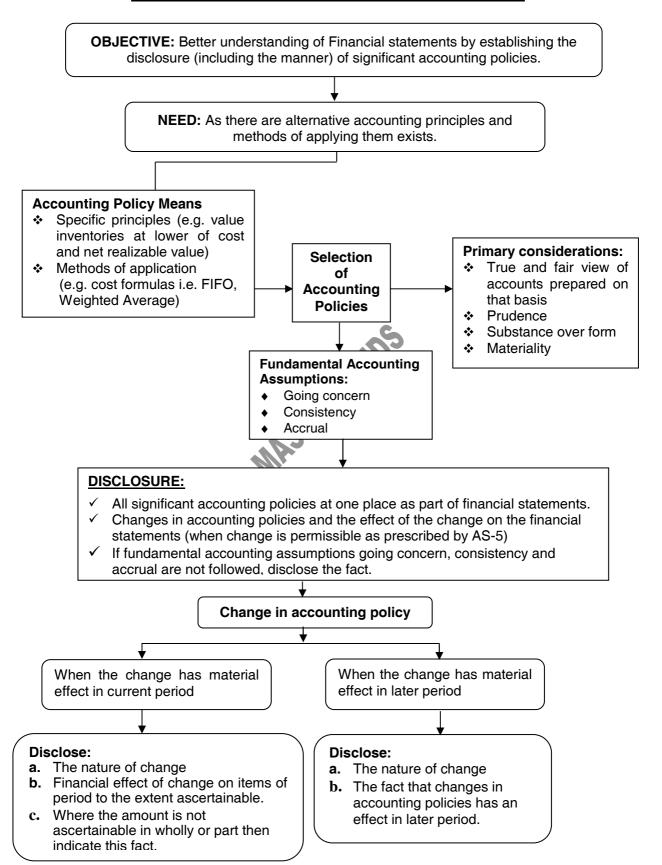
- By CA RADHA MADAM DIRECTOR, MASTER MINDS



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### **ACCOUNTING STANDARDS (GROUP-I)**

#### **AS - 1: DISCLOSURE OF ACCOUNTING POLICIES:**



#### **AS - 2: VALUATION OF INVENTORIES:**

#### **INVENTORIES**

(Includes, finished goods, work in progress, raw material, consumable, loose tools etc.

Which are held for resale or consumption?

#### **VALUATION OF INVENTORIES:**

- ♦ This will be valued at the lower of cost and net realizable value
- on item by item basis but in some cases may be done on group basis

#### Cost Includes

Purchase price + Freight duties and taxes + other expenditures directly attributable to acquisition + cost of conversion.

(Director labour + allocated variable production overhead (based on actual capacity + allocated fixed production overhead.

(Based on normal capacity)

#### ➤ Cost Excludes Abnormal

losses and wastages,
Storage cost,
Administrative expenses,
selling and distribution cost, and interest & other borrowing cost.

In case of finished goods:

Sales value expected at balance sheet date less cost necessary to make the sale.

## In case of raw material or consumable:

**Net Realisable Value** 

If finished product in which raw materials and supplies are used is sold at

## In case of WIP:

It is sale value at balance sheet date less cost necessary to make the sale less estimated of completion.

#### **COST FORMULAS:**

FIFO, Weighted average, Standard cost, retail method, specific identification. LIFO not allowed.

Cost or above cost, then inventories of raw material and supplies will be valued at cost.

Below cost then NRV of that raw materials and supplies is equal to replacement price of raw materials or supplies.

#### Specific Price Method

(For goods which are not ordinarily inter changeable and which are segregated for a specific purpose) For other Inventories
FIFO or Weighted
Average
(Weighted Average can
be calculated
periodically or after
receipt of every new lot)

## Standard cost method

It takes into account normal level of consumption of material & supplies, labour, efficiency and capacity utilization.

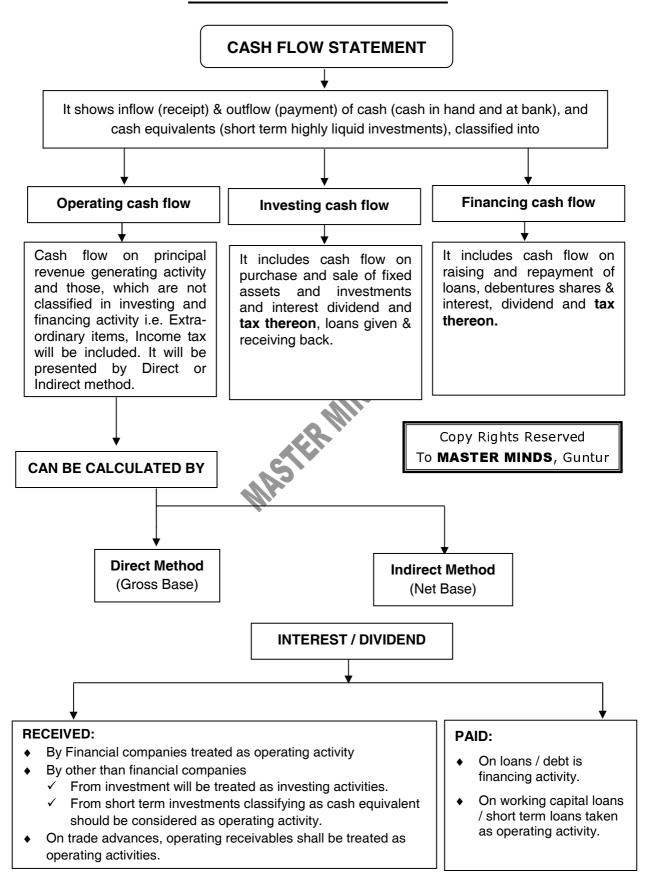
#### Retail method

It is generally used in retail business when it is difficult to ascertain cost of individual item

#### **SPECIAL POINTS:**

- Joint costs to be allocated on a rational and consistent basis, example relative sales value at split off point.
- In case of by products, deduct the NRV of by products from the cost of main products.

#### **AS - 3: CASH FLOW STATEMENT**



#### **AS - 6: DEPRECIATION ACCOUNTING**

MEANING: Depreciation is a measure of wearing out, consumption or loss in value of depreciable asset arising from usage or passage of time and nothing but allocation of cost of asset over useful life of asset.

#### Depreciable assets are those assets:

- ♦ Life of the asset should be more than one year.
- Having a limited useful life.
- Held by an enterprise and use in production or providing goods and services.
- Not held for sale in the ordinary course of business.

No methods or rates Depreciable amount should be prescribed by AS. allocated systematically over its useful life. (SLM or WDV is commonly followed method) Change in Depreciation due to Change in cost (increase or Change of life

#### Change of method

It is a change in **Accounting Policy.** Should be done Retrospectively

- Re-compute the depreciation from the installation date to till date by using new method.
- Finding the difference between the recomputed depreciation and accumulated depreciation.
- ♦ The difference may be surplus or deficit, transfer to Profit and loss account

Balance (i.e. unamortized value) to be w/off in remaining revised life i.e.

prospective effect. It is a change in Estimate.

## decrease) of asset due to

Revaluation/ Foreign exchange diff. Govt. grant / refund of Price / duty changes to be added or deducted from the outstanding book value. Revised balance to be written off prospectively over the remaining useful life of the asset.

If it is an integral part of If it retains a the existing asset separate identify.

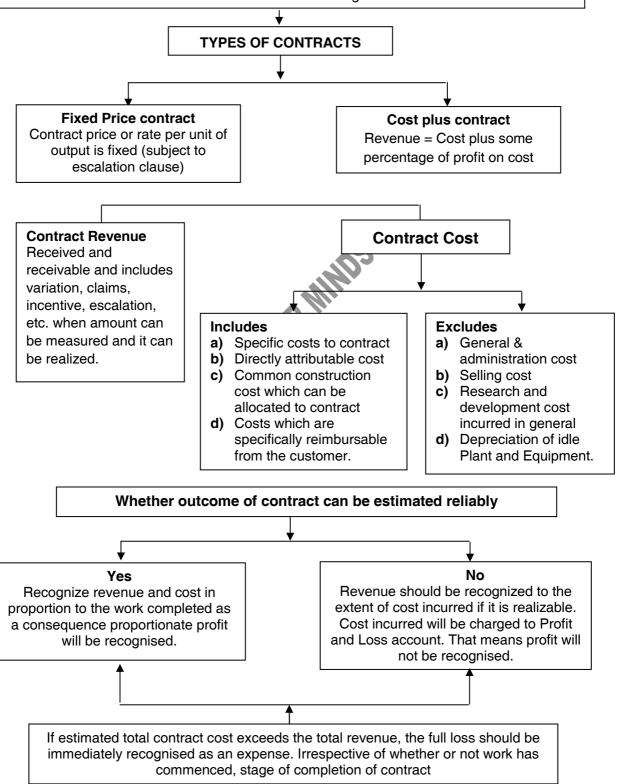
Addition or extension to an existing asset

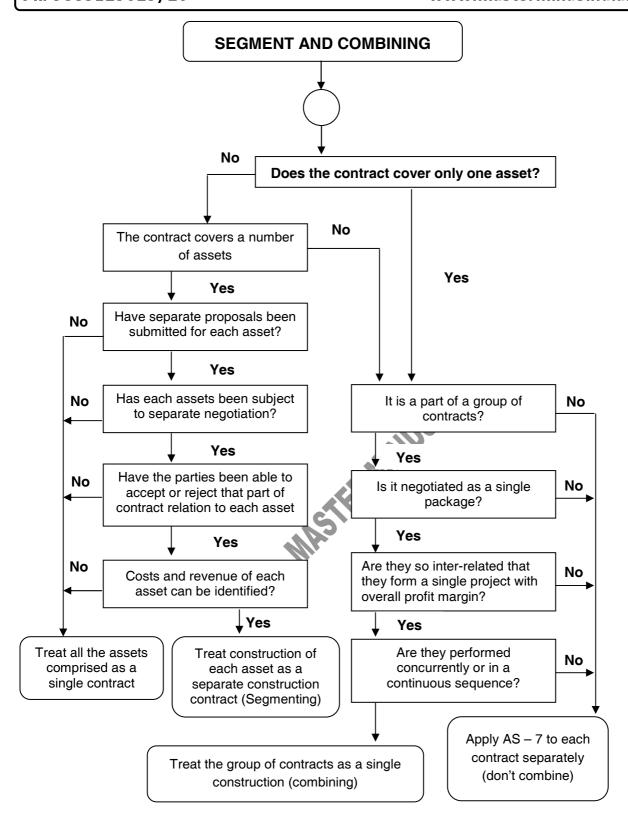
Depreciable at same rate over remaining life of old asset.

Then depreciate it independently

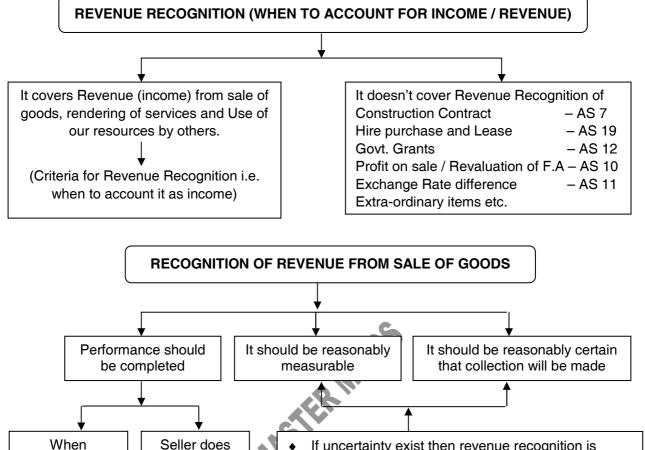
#### **A.S - 7: CONSTRUCTION CONTRACTS:**

- ◆ AS 7 is applicable for accounting of construction contract in the books of contractor. (not applicable for accounts of contractee)
- Apart from normal construction contract, also covers:
  - ✓ Contracts for rendering of services directly related to construction of the assets.
  - ✓ Contracts for destruction or restoration of assets.
  - Contracts for restoration of environment following demolition of assets.





#### A.S - 9: REVENUE RECOGNITION (WHEN TO ACCOUNT FOR INCOME / REVENUE):



# When significant risk and reward associated to ownership is transferred.

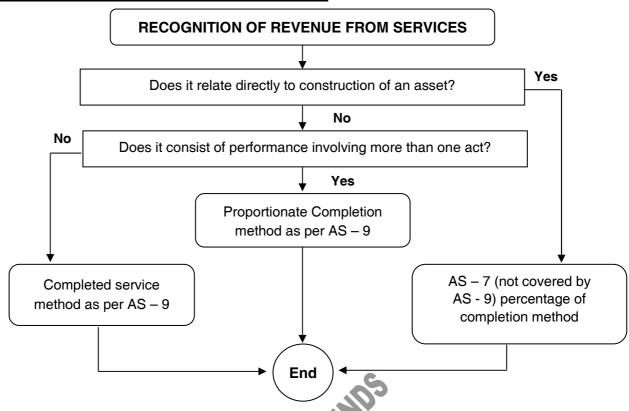
Seller does not retain effective control of ownership of transferred goods

- If uncertainty exist then revenue recognition is postponed to next period and recognised when its becomes reasonably certain.
- ◆ If uncertainty arises after the initial recognition of revenue then it will not be reversed, only appropriate provision to cover losses will be made.

#### RECOGNITION OF REVENUE WHEN DELIVERY OF GOODS SOLD SUBJECT BELOW CONDITIONS

Nature	When revenue is to be recognised
1. Sale on approval	When buyer confirms his desires to buy such goods by communication.
2. Guaranteed Sales	as per the agreement of the sale or after reasonable period has expired
3. Warrantee Sales	Immediately. But provision should be made to cover unexpired period of warranty.
4. Consignment Sales	4. When goods sold to third party
5. Special order and shipments	5. Goods are identified and ready for delivery

#### **RECOGNITION OF REVENUE FROM SERVICES:**



#### **EXAMPLES OF REVENUE RECOGNITION OF SERVICE**

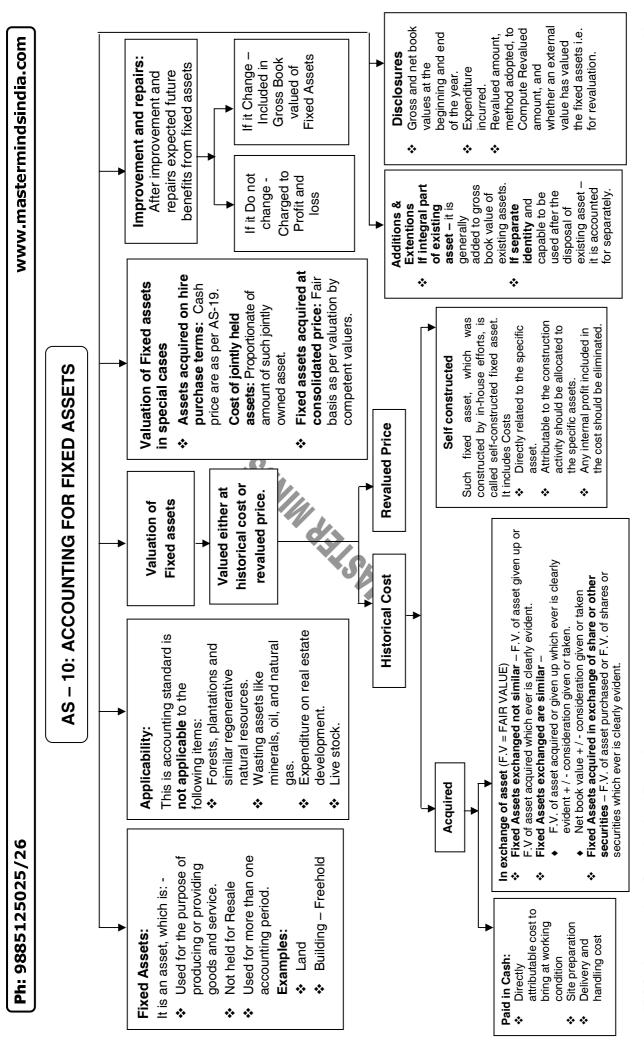
S.NO	NATURE OF SERVICE INCOME	WHEN REVENUE IS TO BE RECOGNIZED	METHOD ADOPTED
1.	Installation fees other than incidental to the sale of a product	Only when the equipment is installed and accepted by the customer.	Completed Service Contract Method
2.	Insurance agency commissions	On the effective commencement of renewal dates of the related policies - do -	
3.	Media commission of advertising agencies	When the related advertisement or commercial appears before the public and the necessary intimation is received by the agency.	
4.	Production commission	When the project is completed	- do -
5.	Revenue from artistic performances, banquets and other special events	When the event takes place. When a subscription to a number of events is sold, the fee should be allocated to each event on a systematic and rational basis.	- do -
6.	Tuition Fees	Over the period of instruction.	Proportionate completion method.

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7.	Commitment facility or loan management fees which relate to continuing obligations or services	Recognized over the life of the loan or facility having regard to  to the amount of the obligation outstanding  the nature of the services provided and the timing of the costs relating thereto.	- do -
8	Commissions charged for arranging or granting loan or other facilities	When a binding obligation has been entered into.	- do -
9.	Membership fee which permits only membership and all other services or products are paid for separately, or if there is a separate annual subscription	When received	Completed Service Contract Method
10.	If the membership fee entitles the member to services or publications to be provided during the year  On a systematic and rational basis having regard to the timing and nature of all services provided.  Proportionate completion me		Proportionate completion method.

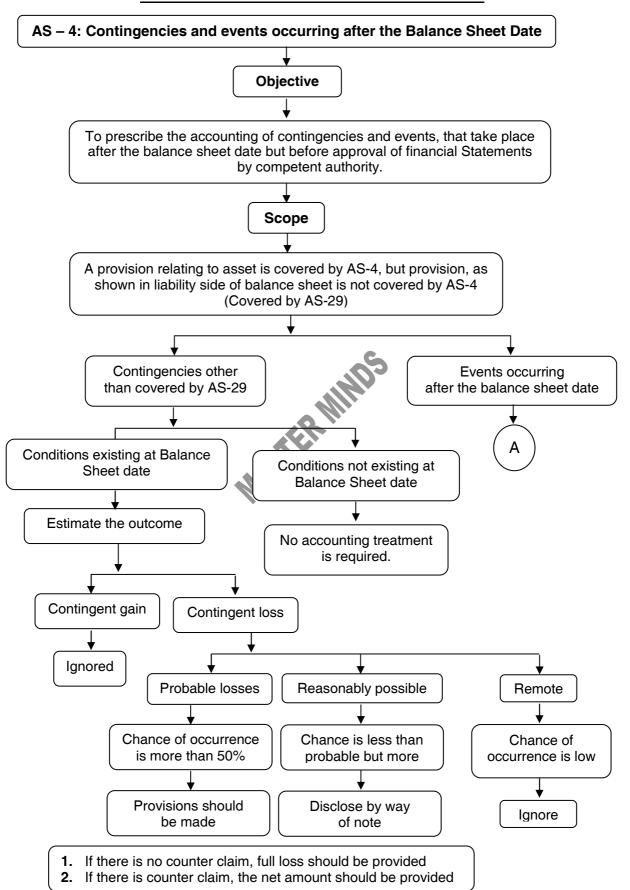
## RECOGNITION OF REVENUE BY USE OF THE ENTERPRISE RESOURCES BY OTHERS

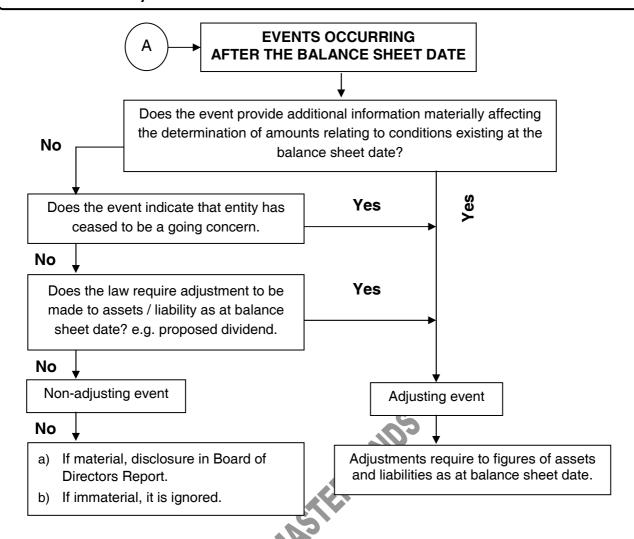
	ITEM OF REVENUE	BASIS OF RECOGNITION
1.	Interest (charges for the use of cash resources or amounts due to the enterprise)	On a time proportion basis taking into account the amount outstanding and the rate applicable
2.	Royalties (charges for the use of such assets as know-how, patents, trade marks and copyrights)	On an accrual basis in accordance with the terms of the relevant agreement.
3.	Dividends from investments in shares (rewards from the holding of investments in shares)	When the owner's right to receive payment is established. (i.e. when dividend declared)
4.	Discount or premium on debt securities	Over the period to maturity in proportion to balance outstanding (Straight line basis) over the maturity period.



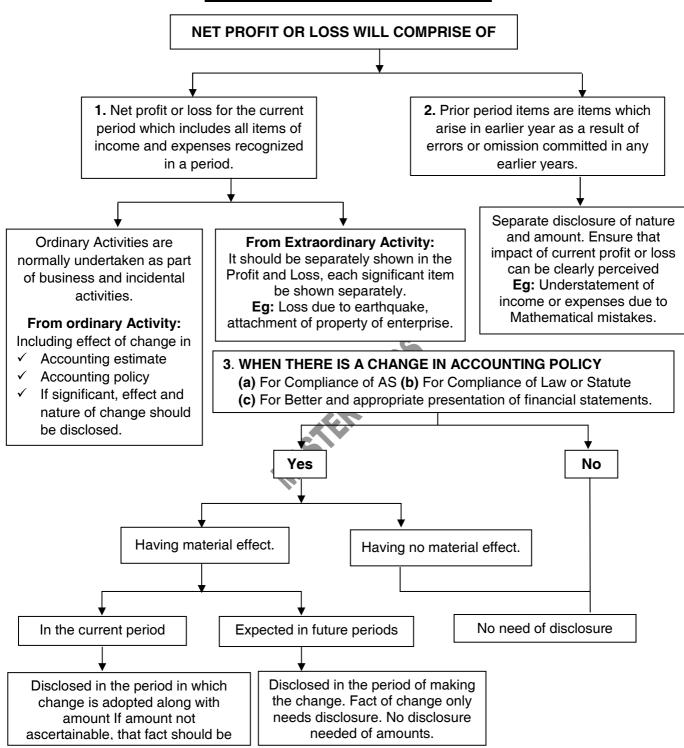
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### **ACCOUNTING STANDARDS (GROUP-II)**



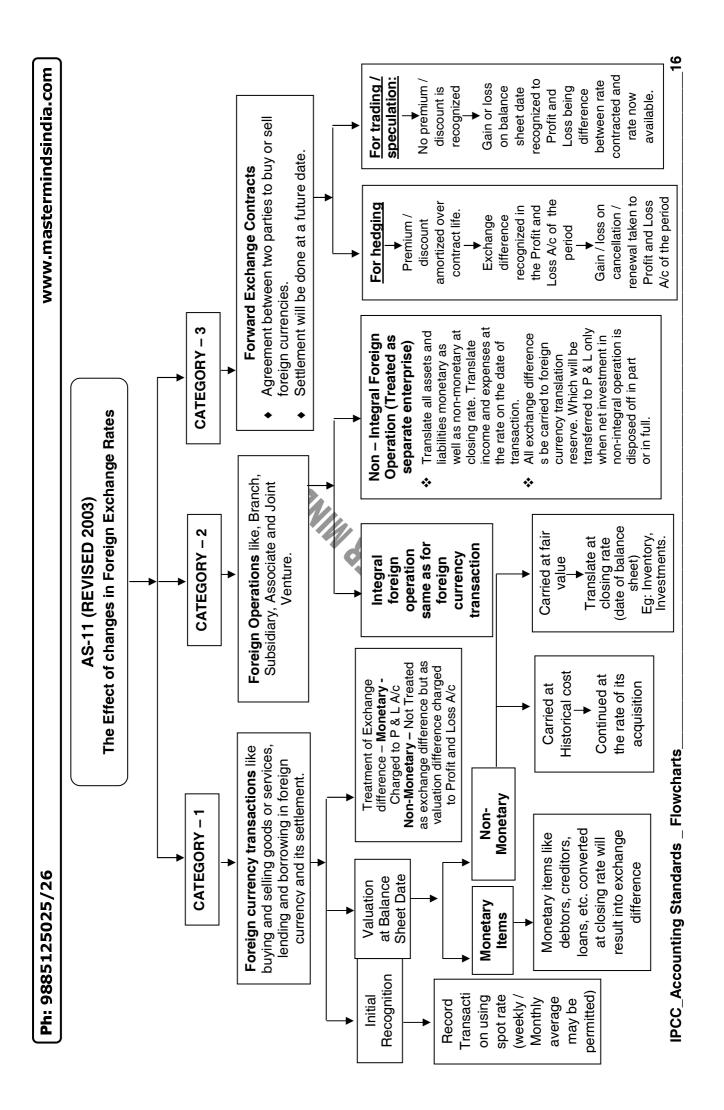


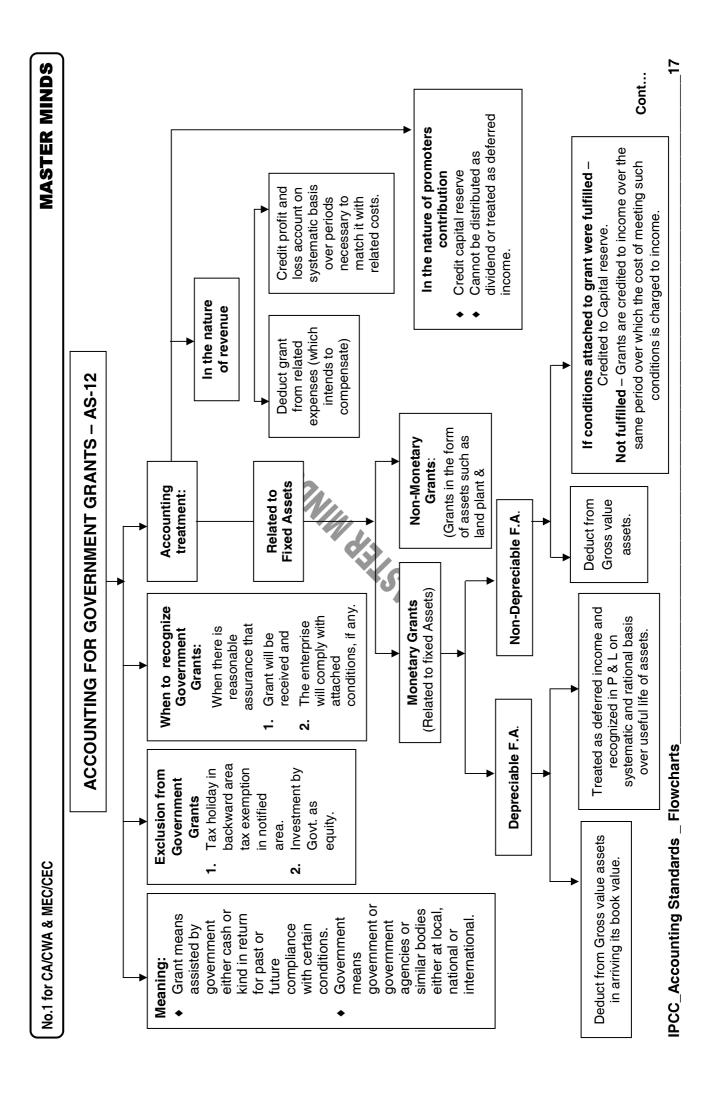
## AS – 5: NET PROFIT / LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS AND CHANGE IN ACCOUNTING POLICIES:

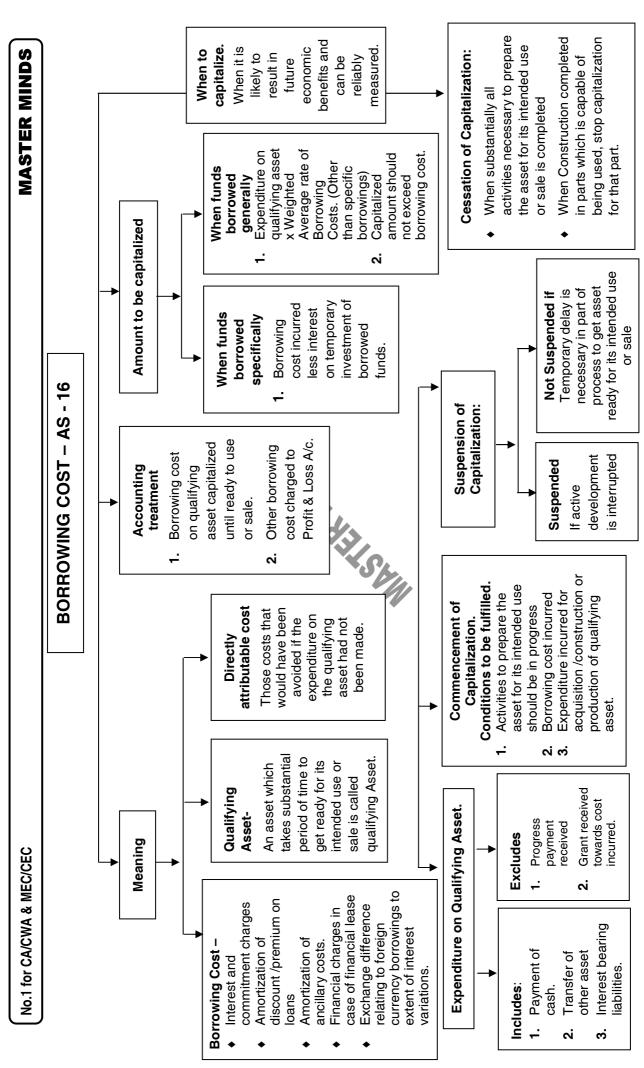


#### 4. Change in accounting estimates:

- Neither a prior period item nor an extraordinary item.
- A change in estimated amount in any items of financial statements.
- When it is difficult distinguish between change in accounting policy and accounting estimates, treat it as change in accounting estimate.
- Example: change in the amount of provision for bad debts, change in useful life of depreciable assets.

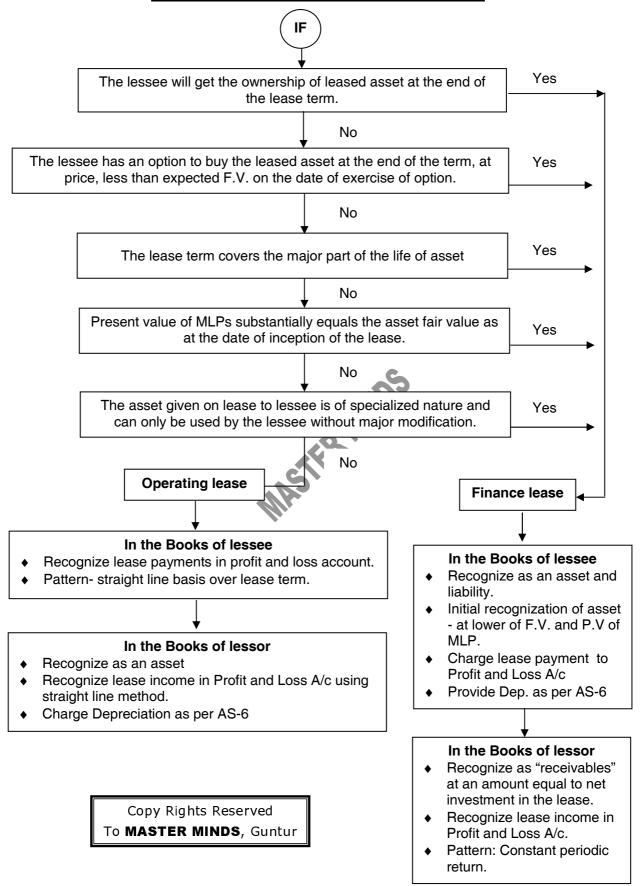






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#### **AS-19: ACCOUNTING FOR LEASES**



#### **KEY TERMS**

- Gross investment = MLP (in view of lessor) + unquaranteed residual value.
- Net investment = Gross investment unearned finance income
- Unguaranteed residual value = Gross investment - Present value of Gross investment
- MLP in view of lessor = lease rentals + any guaranteed R.V. (by or on behalf of lessee)
   + R.V. Guaranteed by third party.
- MLP in view of lessee = lease rentals + any guaranteed R.V. which is guaranteed by or on behalf of lessee.
- Implicit interest rate = discount rate that makes P.V of gross investment just equal to Fair Value of leased asset.
- Faire value of leased asset (at the inception of lease = present value of Minimum lease payments (in view of lessor) + any unguaranteed residual value according to the lessor.
- Guaranteed residual value (in respect of lessee): such part of the R.V., which is guaranteed by or on behalf of the lessee.
- Guaranteed residual value (in respect of lessor) such part of the R.V., which is guaranteed by or on behalf of the lessee or by an independent third party.

## SALE AND LEASE BACK TRABNSACTIONS

 If lease back is finance lease.
 Defer any excess or deficiency of sale proceeds over carrying amount and amortize it over lease term in proportion of dep. on leased asset.

#### If lease back is operating lease

(S.P = Selling Price, F.V = Fair Value, C.A = Carrying Amount)

- If S.P. = F.V : any profit or loss recognize immediately.
- ♦ If S.P. < F.V
  - ✓ **C.A < S.P:** Profit:– Recognize immediately
  - ✓ C.A. > S.P:- Loss:- Recognize immediately
- ♦ If S.P. > F.V.
  - ✓ If C.A. = F.V:- Profit:- amortize the profit over lease period.
  - ✓ If C.A. < F.V:— to the extent of (S.P. – F.V):— Profit:— Defer the profit.
  - ✓ If C.A. > F.V.

    To the extent of (C.A F.V):—

    Loss:— Recognize immediately

    To the extent of (S.P. F.V.):—

    profit:— should be amortized.

#### **AS - 20 EPS (EARNING PER SHARE):**

**EPS (EARNING PER SHARE)** 

#### **BASIC EPS**

Profit available to equity share holders (PAES) / Weighted Avg. No. of Equity Shares (WANES)

#### **Earnings**

- Profit after tax less preference dividend and dividend distribution tax there on.
- In case of more than one class of equity shares – distribute earnings in proportion of dividend right for each class.

#### **DILUTED EPS**

Diluted earnings / Revised WANES

#### **WANES**

- No. of shares (After adjustments for additions and deletions during the period.
- Weight = No. of days shares were outstanding the during the period (Timing)

#### TIMING:

- ♦ Conversion of debt:- Date of conversion
- Settlement of liability:- Date of settlement
- Acquisition of asset:- Recognition
- ◆ Amalgamation in the nature of Purchase:- Date of acquisition.
- ◆ Amalgamation in the nature of merger:- beginning of reporting period.

#### **Dilutive Potential Equity share**

Potential equity share is dilutive: if its inclusion reduces earning per share or increases loss per share

Dilutive EPS = Profit / W.Av. No. of shares

#### **Anti- Dilutive shares**

Potential equity share is anti-dilutive: dilutive if its inclusion increases earnings per share or reduces loss per share

Anti- dilutive shares to be ignored

#### **Diluted Earnings**

PAES + Dividend along with distribution tax on convertible preference shares previously deducted + Interest net of tax effect charged on convertible debentures or loans.

Revised WANES + Weighted average of additional equity shares outstanding assuming conversion.

Potential shares for which proceeds have already been received. Like convertible debenture, convertible preference shares, application money received etc.

Number of equity share to be issued against such potential shares to be considered. Profit shall be adjusted by interest, dividend and consequential tax effect related to such potential share.

Potential shares for which proceeds shall be received in future. Like options

Actual number of shares to be issued less number of shares which can be issued against the same proceeds if issued at average fair value. The balance is the share issued for no consideration and it will be included for calculating diluted EPS. Profit may not require any adjustment for such potential equity shares.

#### **MASTER MINDS**

#### TREATMENT OF DIFFERENT TYPES OF SHARE / POTENTIAL SHARES FOR CALCULATION OF BASIC EPS/ DILUTED EPS

(Note whatever is included for basic EPS gets automatically included for diluted EPS)

#### **EQUITY SHARES APPEARING IN** THE BALANCE SHEET

#### Fully paid

Include from the date of issue for basic EPS

#### Calls in Arrears

If entitled for dividend, include for basic EPS.

If not entitled for dividend include for diluted EPS from the date call is due just like option. If interest has been charged the same will the adjusted from earning

#### **BONUS ISSUE. SHARE SPLIT** CONSOLIDATION

The weighted average number of shares of all the period reported including period of above event (even if the event took place after the balance sheet date but before approval) be reinstated in the same proportion (i.e. increased / decreased in the same proportion)

#### **POTENTIAL EQUITY SHARES**

Convertible debenture / preference share

Usually at fair value, hence include it from the date of issue for diluted EPS. Numbers to be calculated taking best conversion price from holders point. The interest, dividend tax and related exp. be adjusted in the earning.

#### **ESOP**

The deferred employee remuneration will be included in assumed proceeds together with issue price. The rest treatment will be same as in option for calculating diluted EPS.

#### Partly paid

Include for basic EPS in proportion to its entitlement for dividend.

Uncalled on partly paid share

To be ignored

Different nominal value

Different EPS be calculated if having different dividend rights otherwise convert all into same nominal value term for basic EPS.

#### Optional / Share warrants

No. of shares under issue

(-) the number derived by dividing the expected proceeds by fair value of shares.

Balance are the shares for consideration. Same will be included for diluted EPS w.e.f. the date of issue, no adjustment to be made in earnings.

Share application money received (Excess application money to be excluded)

#### Right issue

Right Factor = Fair value per share immediately prior to right issue

Theoritical ex-right fair value per share

Aggregatefair value of share immediately prior to the exercise of the rights+proceeds

from exerciseof the rights Theoritical ex-right fair value =

No. of shares outstanding immediately after the right issue

Money used in business

If all necessary conditions are fulfilled use it for basic EPS

If conditions are not fulfilled use it for diluted EPS like convertible debentures

Money not so used (kept separately)

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Use it for diluted EPS like option

#### Intangible Asset (I.A)

**AS – 26: INTANGIBLE ASSETS** 

- ♦ Identifiable (separable)
- ♦ Non-monetary asset
- Without physical substance

The process of R & D classified into 2 phases.

- Research phase: All expenses incurred are to be charged as expense as and when incurred.
- Development phase: Expenses are to be capitalized if and only following conditions are met.
  - ✓ Technical feasibility of completing I.A
  - ✓ Availability of resources
  - ✓ Intension to complete and use I.A
  - ✓ Ability to use
  - ✓ Probability that I.A. will generate future economics benefits (External market)
  - Expenses incurred can be measured reliably

#### Recognition criteria

- Should have characteristics of asset
- Future economic benefits
- Cost can be reliably measured

Initial measurement at cost

#### **Direct Purchase**

Purchase price and all directly attributable costs

#### Exchange of asset

Fair value of asset given up

#### **Government Grants**

Nominal value (AS-12)

#### Through issue of securities

The fair value of securities issued or a fair value of intangible asset acquired which ever is more clearly evident

Intangible asset is recognized in the books of purchasing company though it is not recognize in selling company provided the amalgamation in the nature of purchase (AS-14).

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#### SPECIAL POINTS

#### In some cases, the enterprise incurred expenditure but no intangible asset is recognized EXAMPLES

- Employee training expenses
- Advertisement and promotional expenses
- Relocating expenses
- Restructuring costs

#### Subsequent expenses on intangible asset capitalize if

- ◆ Subsequent expenses increase the future economic benefits of intangibles
- Subsequent expenses can be attributed to cost and measured reliably.

#### Impairment loss

- Impairment test is must, if
  - ✓ Asset not available for use
  - Amortizatio n period exceeds 10 years

## Gain or loss on retirement / disposal:

Recognize in Profit and Loss Account

## De-Recognition of intangible asset

- ♦ On disposal or
- When no future economic benefits expected.

#### **Amortization**

- Carry the asset at cost less accumulated amortization and accumulated impairment loss.
- ♦ Useful life -"10 years" unless there is clear evidence of longer life
- ♦ Residual value "Zero" unless commitment by third party to by at the end of useful life
- Method of amortization
  - ✓ The benefit derived from the intangibles should be matched with the amortization expenses.
  - ✓ If pattern of benefit is available amortize as per pattern
  - ✓ If no pattern is available SLM should be followed.

#### AS-29: PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

